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An Oasis in the Desert: The Emergency of Israeli investment Treaties in the Global Economy

Efraim Chalamish

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EFRAIM CHALAMISH*

I. INTRODUCTION

Recent changes in the global economy have forced countries to compete on foreign direct investment (FDI) more forcefully in order to increase their respective growth and development. Capital-exporting countries have simultaneously become more concerned with the economic and physical protection of their citizens' investments abroad, while diversifying their investments worldwide. Bilateral Investment Treaties (BITs) have been used by governments to encourage mutual flows of foreign investments between the contracting parties and to protect these investments. Since 1959, when the first BIT was introduced to the international economic community, the BITs' network has expanded dramatically and today consists of more than 2,500 treaties worldwide.

Most BITs include a bilateral commitment of both governments to encourage foreign investments in their countries and protect such investments. According to such treaties, investors enjoy national treatment and most-favored-nation protection standards. Additionally, BITs offer investors an enforceable dispute settlement mechanism that allows them to initiate an investor-state procedure in order to recover their investments.[1] Traditionally, BITs did not include any development aspects,

* S.J.D., L.L.M. (University of Michigan), LL.B., LL.M., M.B.A. (Bar Ilan University). I would like to thank the government officials who made this research possible, including Mayor Admon, Yoel Berris, Danny Catarivas, Hadassah Greenberg, and Zvia Gross. I am grateful to Reuven Avi-Yonah, Robert Howse, and Marina Whitman for their helpful comments on earlier drafts of this Article. All errors are my own.

1. Efraim Chalamish, *The Future of Bilateral Investment Treaties: A De Facto Multilateral Agreement?*, 34 BROOK. J. INT'L L. 303, 315-16 (2009).

although several initiatives led mainly by the non-governmental organization (NGO) community have called for such inclusion.

Although these treaties share similar structure, investors' rights, and obligations,[2] they can serve as a substitute for multilateral investment agreements, and they have frequently reflected the need to balance the encouragement of FDI with the protection of national interests and local businesses. Developed and developing countries have reached a consensus regarding the need to protect foreign investments and the acceptable level of protection.[3] However, the process of treaty negotiation and drafting provides the parties with an opportunity to adjust customary and treaty law based on the specific needs and interests of the contracting parties.

Israel became a developed economy and emerged as a capital exporter in a relatively short period of time, and serves as a fascinating precedent for other developing economies. These emerging economies face similar changes and struggles, balancing the need to protect national interests with encouragement and protection of foreign investments. In addition, while extensive writing has discussed Israel's innovative trade policy and its groundbreaking integration into the European and other global markets, there has been no recent academic writing about its corresponding investment policy, which has been recently reshaped by the adoption of a new model investment treaty. In light of past, present, and possible future practices, this calls for an updated and comprehensive analysis of Israel's FDI and BIT policy.

This article will analyze the evolution of Israeli investment treaties. The first part will discuss the investment policy in Israel, in the context of Israel's transition from a capital-importing economy to capital-exporting economy. This article suggests that Israel's transition has played a major role in developing investment treaties in Israel. Next, this article will examine the background and development of the 2004 Israel New Model Bilateral Investment Treaty, which serves as the basic framework for all future BITs that are negotiated by the Israeli government. Finally, this article will present an overview of the existing investment

2. *Id.* at 323.
3. *Id.* at 344-45.

treaties in Israel and the key provisions of the 2004 Israel New Model Bilateral Investment Treaty. The provisions will be discussed in light of the evolving investment arbitration jurisprudence, comparing the Israeli model and existing Israeli investment treaties with other investment treaty models.

The multilateralism aspect of the investment treaty network, which has been referred to by some scholars as the "common law" of investment arbitration,[4] impacts the way investment arbitral tribunals interpret common investment treaty provisions using arbitration precedents.[5] Therefore, a close examination of the rights and obligations of states and investors in the Israeli model will help us better understand the level of implementation and deviation from investment law jurisprudence in Israeli investment treaties.

This analysis will be based on a series of interviews conducted with Israeli government officials between 2004 and 2007 and official investment treaty documentation. The 2004 U.S. Model BIT,[6] among several other models, will serve as a major point of reference in our analysis. The 2004 U.S. Model BIT will serve as our primary reference because it implements a significant part of the developing investment arbitration jurisprudence and represents a new model of investment agreement in a free trade agreement.[7] Moreover, the 2004 U.S. Model BIT calls for a better balance between the national interests of countries or host states that receive foreign investments and the protection of foreign investors by including additional provisions on environment and labor rights, to name a few, in the investment treaty.[8] This article

4. *See, e.g.*, CAMPBELL MCLACHLAN ET AL., INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES 18-21 (2007).

5. *Id.*

6. Treaty Concerning the Encouragement and Reciprocal Protection of Investment, *available at* http://www.state.gov/documents/organization/117601.pdf.

7. The first treaty to apply the U.S. 2004 Model BIT was the U.S.-Uruguay BIT, which was signed on November 4, 2005 and entered into force on November 1, 2006. The U.S.-Uruguay BIT is the first BIT the United States has concluded since 1999.

8. For example, the International Institute for Sustainable Development in its IISD Model International Agreement on Investment for Sustainable Development [hereinafter IISD Model] called for adoption of such provisions. *See* HOWARD MANN ET AL., INT'L INST. FOR SUSTAINABLE DEV., IISD MODEL INTERNATIONAL AGREEMENT ON INVESTMENT FOR SUSTAINABLE DEVELOPMENT 12-13 (2005), *available at* http://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf [hereinafter IISD MODEL AGREEMENT].

will further examine how Israel should deal with the evolving trends in international investment law moving forward.

II. ISRAEL AND FOREIGN INVESTMENT

In order to fully understand Israel's investment policy and its BIT program, a careful review of the characteristics of its economy, along with its recent structural changes, is required.

> "In the past several years, the Israeli economy has been undergoing a comprehensive pro-market, pro-competition structural reform program: reducing government expenditures, cutting taxes, . . . [reforming legal frameworks in areas that affect business operation conditions,] breaking up monopolies, privatizing state-owned companies and banks, promoting competition, reforming the pension system, [and] reforming the capital market."[9]

This reform has gradually but dramatically reduced the political and economic risk of foreign investment in Israel.[10] As a result, the Israeli government's need to sign BITs in order to protect and increase foreign investment has diminished significantly. Indeed, the total inflows of foreign investments in 2006 increased three fold over the total inflows in 2005,[11] indicating sustainable long-term investments.[12] The increase in total inflows of foreign investment was boosted by direct investments in the rapidly expanding high-tech sector in Israel, and portfolio investments in Israel's capital markets, primarily through the Tel Aviv Stock Exchange, which have been "free from almost all exchange controls since 1998."[13] The total number of FDI inflows

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9. *ISRAEL: Ready for the OECD* 13, International Department, Ministry of Finance, the Government of Israel (March 2006).

10. *See id.* ("IMF staff statement at the conclusion of a visit to Israel, on December 12, 2005, said Israel's 'commitment to increased competition and efficiency has enhanced market confidence and is crucial in fostering sustainable growth.'") (emphasis removed).

11. United Nations Conference on Trade and Development (UNCTAD) Foreign Direct Investment Database, http://www.unctad.org/Templates/Page.asp?intitemID=3198&lang=1 [hereinafter UNCTAD Foreign Direct Investment Database].

12. MARC LUBAN, ISRAEL MINISTRY OF FINANCE, ISRAEL: READY FOR THE OECD (2007), http://cooperazione.formez.it/sections/documenti/israel-ready-for-the/downloadFile/attachedFile_f0/israel_oecd.pdf?nocache=1179891521.92.

13. *Id.* at 20.

continued to be high in 2007 and 2008, even in times of financial crisis and global economic slowdown.[14]

Although mainly associated with the import of capital, Israel has also faced a significant recent expansion towards Israeli investments abroad.[15] The total FDI outflows in 2006 were 14.9 billion U.S. dollars, while the total FDI inflows were 14.8 billion U.S. dollars during the same period.[16] Thus, Israel became an important player in several foreign markets, some of which are developing countries. In turn, these foreign markets called for the protection of foreign investments coming out of Israel. This article will explore the main factors behind Israel's transition from being a capital-importing country to a capital-exporting one in order to better understand the nature of investment treaties between Israel and other countries, and how the current structure of Israeli investment treaties reflects and advances this transition.

A. Regional and Geopolitical Developments

The Israeli economy is tied to Middle Eastern trends and, since the establishment of the State of Israel in 1948, has been substantially influenced by the political and security circumstances in the region. New diplomatic relations that were crafted during the Oslo Agreements in the mid 1990s initially brought forth new investment opportunities for Israeli investors in Jordan and other areas of the world. In recent years, certain developments in the peace process between Israel and several Arab countries have opened the door for Israeli investments in countries that traditionally had limited or completely lacked diplomatic and economic relations with Israel. For example, geopolitical changes in the Middle East and the negotiations between Israel and the Palestinian Authority allowed Israelis to invest indirectly in Iraq.[17]

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14. *See* ISRAEL MINISTRY OF FINANCE, INT'L AFFAIRS DEP'T, ECONOMIC HIGHLIGHTS at 5-6 (2008), http://www.financeisrael.mof.gov.il/FinanceIsrael/Docs/En/EconomicHighlights/EconomicHighlights-2008-2.pdf.

15. *See* SANBAR ET AL., ECONOMIC AND SOCIAL POLICY IN ISRAEL (1989); Press Release, Bank of Israel, Nonresident Investment in Israel and Resident Investment Abroad, July 2009 (Aug. 9, 2009), *available at* http://www.bankisrael.gov.il/press/eng/090908/090908r.htm.

16. *See* UNCTAD Foreign Direct Investment Database, *supra* note 11.

17. The estimated Israeli export potential in Iraq is US$250 million per annum. *See* Iason Athanasiadis, *Israeli Firms in Post-Ba'athist Baghdad*, ASIA TIMES, Oct. 21, 2003, http://www.atimes.com/atimes/Middle_East/EJ21Ak05.html for a further discussion on the ways Israelis can conduct business in Iraq without the impact of the anti-Israel movement.

The collapse of the Soviet Union, the rapid economic growth of Eastern European countries, to which many Israeli citizens have strong ties, and the enlargement of the European Union created new investment opportunities for Israel and increased the Israeli direct investment outflows in these regions.

In addition to these political factors, several countries encouraged foreign investment from Israel as a strategy for achieving normalization, including reciprocal diplomatic and economic relations. In many cases, Israeli investments in foreign countries are a reflection of a mutual attempt to normalize diplomatic and economic relations.[18] This is especially true when it comes to developing and least developing countries, which tend to seek the benefits of advanced industries, such as the know-how of Israel's high-tech industry.

B. Internal Structural Changes

Besides diplomatic and economic changes, the Israeli economy has gone through some internal structural changes in an attempt to keep up with developments in the global economy. The Israeli market has tried to enhance efficiency by focusing on industries where it has a competitive advantage, for example, Research and Development ("R&D") industries. Many other industries that operate less efficiently in Israel have prompted various levels of outsourcing, further enhancing Israeli investments abroad.[19]

C. Israeli Multinationals

Another interrelated economic phenomenon is the recent development of Israeli multinational corporations. While in the past most Israeli companies were managed and operated in Israel, today it has become common practice for Israeli companies to be

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For example, Israeli business professionals can sell supplies to Jordan, where the products are repackaged and sold to Iraq without Israeli labeling.

18. Interview with Mayor Admon, Ministry of Fin., Gov't of Isr., in Jerusalem, Isr. (Nov. 7, 2007) (explaining this phenomenon in detail) [hereinafter ADMON INTERVIEW I].

19. Accordingly, while Israel serves as an IT outsourcing center for many multinational corporations, it prefers to outsource low-tech industries. *See generally* ATUL VASHISTHA & AVINASH VASHISTHA, THE OFFSHORE NATION: STRATEGIES FOR SUCCESS IN GLOBAL OUTSOURCING AND OFFSHORING (2006).

multinational by nature, especially in a high-tech industry.[20] The new global presence was accompanied by raising capital in foreign capital markets, primarily in the United States.[21] A recent cross-border study of Israeli multinationals shows that as of July 2008 the top 15 Israeli multinationals have 7.5 billion U.S. dollars in foreign assets, over 21 billion U.S. dollars in foreign sales, including exports, and employ nearly 63,000 persons abroad, making Israel one of the top 20 countries in terms of outward FDI flows.[22] These figures indicate that new Israeli multinationals have transferred a significant portion of their investments to foreign markets. Throughout the years, the Israeli government played a crucial role in this transformation by signing Free Trade Agreements. These agreements reduced commodities and service costs and increased production and marketing efficiency, thus fostering multinational operations.[23]

D. Foreign Currency Liberalization

As the trends of globalization and internal economic changes in the Israeli market have opened up the foreign currency market for competition, a similar process has occurred in foreign currency liberalization. For example, one important change in the new currency regime is the ability of Israeli companies to invest in subsidiaries abroad. Such investments have become a significant portion of Israeli investments in foreign markets. Furthermore, tax planning, an integral part of the evolving international tax regime,

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20. *See* Nisso Cohen, *The Israel High-Tech Industry – Fifty Years of Excellence*, SPOTLIGHT ON ISRAEL (Israel Ministry of Foreign Affairs), Oct. 20, 2002, *available at* http://www.mfa.gov.il/mfa/facts%20about%20israel/science%20-%20technology/the%20israel%20high-tech%20industry%20-%20fifty%20years%20of%20exc.

21. *Id.*

22. Press Release, Vale Columbia Ctr. on Sustainable Int'l Inv., Israeli Multinationals Rise in Foreign Markets: Release of the First Ranking of Israeli Multinational Enterprises (July 9, 2008), http://www.vcc.columbia.edu/projects/documents/Israel_Press_Release__June_28_final.pdf.

23. Among these Free Trade Agreements are agreements with the EU, United States, Mexico, Canada, Bulgaria, Turkey, Romania, Jordan, Egypt, and EFTA (Iceland, Liechtenstein, Norway, and Switzerland). *See* Mandatory Tenders Regulations (Preference for Israel Products and Mandatory Business Cooperation), 1995, KT 5755, 562, § 3(a) (Isr.).

allows Israeli companies to invest in low-taxed subsidiaries in order to reduce their total tax exposure.[24]

E. Summary: From Import to Export of Capital

All of these trends have gradually accumulated to position the Israeli economy as a capital exporter economy, increasing the level of direct investment outflow abroad and opening many new markets for Israeli investors. New circumstances required the Israeli administration to reshape its FDI policy and international economic agreements in a way that supports Israel's new economic interests, for example, by advancing local inflows while protecting increasing outflows abroad. As expressed by the *Saluka* arbitral tribunal and other tribunals and critics, the eventual economic goal behind investment treaties is the encouragement of foreign investment in the host state.[25] This type of investment is an essential engine for economic growth. However, the treaties' text and investment arbitration cases have historically focused on the protection of foreign investment in unstable economies through an objective and de-politicized dispute resolution mechanism. The desire to provide safer investments in Israel, and the change in the balance of import-export of capital, call into question the role of such protective investment treaties in international economic agreements and the preferred model in Israel. In an attempt to answer this question and understand the reaction to the new global and local developments in investment law, the following section discusses the factors involved in the Israeli government's policy towards negotiation and signing investment treaties.

III. ISRAELI BILATERAL INVESTMENT TREATIES- POLICY AND STRATEGY

The Israeli government's policy regarding BITs involves numerous factors including the long-term strategy to integrate the Israeli economy into the global economy, budget constraints, and

24. The European Court of Justice confirmed the legality of such structure in the European Community on September 12, 2006. *See generally* Case C-196/04, Cadbury Schweppes plc v. Comm'rs of Inland Revenue, 2006 E.C.R. I-7995.

25. Saluka Investments B.V. v. Czech Republic, Partial Award, ¶ 300 (Perm. Ct. Arb. 2006), *available at* http://www.pca-cpa.org/upload/files/SAL-CZ%20Partial%C20Award%20170306.pdf.

political preferences.[26] Many of these factors seem conflicting, but a careful review of the Israeli government's strategy and treaty-making process raises the question of whether a coherent policy does indeed exist. Similar to other governmental functions, shaping this policy and negotiating the treaties involves multiple agencies with colliding interests, changing administrations, and other internal structural constraints. Nevertheless, in the absence of interpretation notes to the BITs and the Israeli model draft treaty,[27] this section will examine the policy as it emerged from governmental documents and in-depth interviews with the appropriate government officials.

A. Investment Protection

The Israeli government distinguishes between its policies towards developed and developing countries. This difference reflects how Israel is in transition from being a developing country to a developed one.[28] The interesting correlation between the self-definition of the economy and its BITs policy may shed light on why countries sign BITs and what they try to achieve through this process.

First, Israel traditionally tends to avoid negotiating BITs with other developed countries, as part of the view that developed countries should not sign BITs among themselves. The reason for this is, at least in theory, clear. Developed countries with democratic institutions, liberal economy, and strong enforcement of commercial practices simply lack the fundamental need to sign

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26. Oded Boneh, *Bilateral Investment Treaties at the Israeli* Context, 26 ha-Riv' on ha-Yiśre' eli le-misim [The Israeli Tax Review] 45, 56 (1977) (Isr.). Mr. Boneh served as the head of the Bilateral Investment Treaties group, International Department, Israeli Ministry of Finance, till 2004. Several parts of this section are based on interviews conducted with Mr. Boneh in April 2004 in Tel Aviv, Israel.

27. These interpretation notes could have been a reliable source of information regarding investment treaties policy. *See, e.g.*, Treaty Concerning the Encouragement and Reciprocal Protection of Investment, art. 31, *available at* http://www.state.gov/documents/organization/117601.pdf [hereinafter U.S. 2004 Model BIT].

28. Mr. Mayor Admon, Deputy Director of International Department, Ministry of Finance, the Government of Israel, perceives this transition as the leading vehicle for the development of the BITs policy in recent years in Israel. *Accord* Interview with Mayor Admon, Deputy Dir. of Int'l Dep't, Ministry of Fin., Gov't of Isr., in Jerusalem, Isr. (Apr. 2004); Interview with Mayor Admon, Deputy Dir. of Int'l Dep't, Ministry of Fin., Gov't of Isr., in Jerusalem, Isr. (Dec. 2004); Interview with Mayor Admon, Deputy Dir. of Int'l Dep't, Ministry of Fin., Gov't of Isr., in Jerusalem, Isr. (Mar. 2006).

BITs in order to protect investors from expropriation or regulation that affects their investments. Since Israel views itself as a developed country with a stable economy, it has made it a general rule not to sign or negotiate BITs with other developed countries, with the exceptions of France and Germany.[29]

Negotiating and signing such agreements with other developed countries could send a bad signal to international markets and hurt Israel's status, credit ratings by international agencies, or potential for future investments.[30] Moreover, Israel is consistently trying to develop and maintain its image as a developed and stable country, both politically and financially. For example, the Ariav Committee of the Ministry of Finance has recently examined ways to transform Israel into a global financial center.[31] Any attempt to protect foreign investments in Israel through BITs undermines such a strategy.[32] Consequently, Israel finds it unnecessary to push for such agreements with countries where Israeli investors already enjoy a stable political and economic atmosphere, along with a reliable justice system.[33] According to this argument, Israeli BITs with Western and other

29. Treaty Between the State of Israel and the Federal Republic of Germany Concerning the Encouragement and Reciprocal Protection of Investments, Isr.-F.R.G., June 24, 1976, *available at* http://www.mfa.gov.il/mfa/usercontrols/TreatFile.aspx?SAFA=2&AMANA=774 [hereinafter Israel-Germany BIT] (entered into force temporarily on August 28, 1980). This agreement reflects a period of time when Israel was still considered a developing market among major European markets; Entre le Gouvernement de la Republique Française et le Gouvernment de l'Etat d'Israel sur l'encouragement et la protection reciproques des investissements [Treaty between the Government of the Republic of France and the Government of the State of Israel Concerning the Encouragement and Reciprocal Protection of Investments], June 9, 1983, Fr.-Isr., J.O., Feb. 17, 1985, p. 2087, *available at* http://www.unctad.org/sections/dite/iia/docs/bits/france_israel_fr.pdf.

30. Later in this paper, we will examine the recent extensive academic literature on the true effect of bilateral investment treaties on investment decision and volume of FDI inflows and outflows. The signal to credit rating agencies is clearly influenced by the mixed results of these studies. *See infra* pp. 120-125.

31. Moti Bassok, *Ariav's Dream: Turn Israel into a Global Financial Center*, HAARETZ (Mar. 24, 2008), *available at* http://www.haaretz.com/hasen/spages/967373.html.

32. The Israeli government, for example, rejected several attempts by the Swiss government to initiate negotiations on a bilateral investment treaty as a prerequisite to negotiate and sign a double taxation treaty between the two countries. As a matter of policy, Israel did not want to signal that it is open to negotiate BITs with developed countries, including Switzerland. Memorandum from Int'l Dept., Ministry of Fin., the Gov't of Isr. on Bilateral Investment Treaty with Switzerland (March 4, 1997) (on file with the author).

33. *Id.*

developed countries that already preserve pro-investor environment simply waste valuable governmental resources.[34]

There is also an unbalanced bargaining power between Israel and other developed countries when it comes to investment protection and incentives. Israel is a much smaller market than other developed countries, which means that the main capital movement is into Israel and not vice versa.[35] Israel has to keep the ability to control and regulate basic financial elements, even in the new era of liberalization of foreign currency and financial markets because it has been under an official emergency regime since first obtaining independence in 1948.[36] In fact, the global financial crisis of 2008 will increase the need to control these markets more carefully. In previous years, when Israel did negotiate a few BITs with other developed countries, such as Germany, those countries refused to accept Israel's policy of restrictions on foreign currency.[37] This unbalanced situation that reflects a unique Israeli reality also plays a role in deterring Israel from promoting BITs with other developed countries.[38]

When it comes to developing countries, on the other hand, Israel finds itself in a completely different position. Israel is consistently trying to negotiate and sign BITs with developing countries, especially where it has an interest in protecting Israeli investments in an unstable economy, such as in the Russian Federation case.[39] As previously discussed, Israel has become an

34. Public funds are needed to fund negotiation, implementation of and compliance with a treaty. On the transactional costs of international treaties, *see* William J. Alceves, *Institutionalist Theory and International Legal Scholarship*, 12 AM. U. J. INT'L L. & POL'Y 227, 244 (1997).

35. *See* Economy: The National Economy, Isr. Ministry of Foreign Affairs (Apr. 1, 2008).

36. *See* Defence (Finance) Regulations, 1941 (Palestine Gazette, Supp. No. 2, 1053).

37. Israel-Germany BIT, *supra* note 29, art. 7.

38. Israel did negotiate and sign several BITs with developed countries, such as England, France, Canada, and Italy, at times when Israel's economy was still considered an unstable economy. These agreements are not applicable anymore, and the Israeli government is not willing to renew them due to reasons mentioned in the previous discussion.

39. A growing number of Israeli investments in Russia and several cases of expropriation of such investments brought about extensive negotiations between the two governments. Nevertheless, as of today, the parties could not come to an agreement, mainly due to Russia's desire to maintain absolute control of the dispute settlement mechanism in case of expropriation. Memorandum from Int'l Dep't, Ministry of Fin., Gov't of Isr., on Bilateral Investment Treaties - Status (January 30, 2005) (on file with the author).

emerging source of outflow investments worldwide, exposing Israeli investors to new political and economic risks. Among such risks are direct and indirect expropriation, nationalization, lack of dispute resolution and compensation mechanism in case of expropriation, and inability to freely transfer funds.[40] Protecting these investors has become one of the main goals of Israel's BIT policy. Bilateral investment treaties can provide effective solutions to some of these risks when investors are not covered by foreign trade risk insurance policies.[41] It is also important to note that Israel is using its bargaining power against its developing counterparts to include certain rights or exceptions in investment treaties to protect its own national interests, such as the ability to control certain industries in times of a national emergency.[42]

The protection of Israeli investors by investment treaties in foreign countries raises the question of Israel's obligation to protect its citizens and their property abroad, and how this obligation can be satisfied. Although these questions are beyond the limits of this article, it should be noted that international law scholarship and jurisprudence has increased the level of diplomatic protection of citizens under international law paradigms to include property in a foreign territory.[43]

B. Investment Encouragement

Protection of foreign investment in an unstable economy is not the only dimension of the bilateral investment treaty. As defined by the majority of treaties, a BIT is also designed to signal a friendly environment towards foreign direct investment in the

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40. *See* Patrick J. Donovan, *Creeping Expropriation and MIGA: The Need for Tighter Regulation in the Political Risk Insurance Market,* 7 GONZ. J. INT'L L. 1, 10 (2003-04); *see also* Mark L. Muzere, *The Effects of Restricting Capital Outflows on Investment In an Open Economy,* 22 J. APPLIED BUS. RES. 15, 16 (2006).

41. U.N. Ctr. on Transnational Corp. [UNCTP], *Bilateral Investment Treaties*, ¶ 10, U.N. Doc. ST/CTC/65 (1988).

42. *See, e.g.*, Agreement between the State of Israel and Serbia and Montenegro for the Reciprocal Promotion and Protection of Investments, Isr.-Serb. & Mont., July 28, 2004, art. 7(1), *available at* http://www.mfa.gov.il/mfa/treaties/israel bilateral agreements (allowing the parties to take measures strictly necessary for the maintenance or protection of its essential security interest).

43. The leading case on this matter was the Barcelona Traction Case. *See* The Barcelona Traction, Light and Power Co. (Belg. v. Spain), 1970 I.C.J. 4 (Feb. 5) ("When a State admits into its territory foreign investments or foreign nationals . . . it is bound to extend to them the protection of the law . . . .").

host country, and thus fosters investment regardless of whether the host country is developed or still developing.[44] However, as will be discussed later in this paper, empirical studies still show conflicting results as to the effectiveness of BITs as a tool for increasing foreign investment.[45] As a result, the assumption that investment treaties will necessarily increase foreign investments either in Israel or in another potential host country remains unresolved. Consequently, this component is no longer a fundamental element in the Israeli administration's BIT strategy.[46]

Despite the potential risks associated in BITs with developed countries mentioned above, several attempts have been made in recent years to initiate BIT negotiations with developed countries and to encourage investment in the Israeli market. For example, there were talks with South Korea over a bilateral agreement between the states (which includes an investor-state dispute settlement mechanism) and an incentives agreement between a state and an individual corporation (which provides company-specific incentives in connection with the investment).[47]

C. Exports and Global Trends

In order to increase the Israeli export base abroad, and assuming that an investment treaty can promote this goal through a nexus of investment and trade, Israel is encouraging foreign Israeli investments in developing countries. This is especially encouraged through Israeli multinationals, such as those involved in R&D, production and distribution centers, as well as joint

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44. *See, e.g.*, U.S. 2004 Model BIT, *supra* note 6 ("*Recognizing* that agreement on the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties").

45. *See, e.g.*, Zachary Elkins, Andrew T. Guzman and Beth A. Simmons, *Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000*, 60 INT'L ORG. 811, 843 (2006) (paper presented at the annual meeting of the American Political Science Association (September 2, 2004)).

46. Interview with Dan Catarivas, Dir. of the Int'l Dep't, Ministry of Fin., the Gov't of Isr., in Jerusalem, Isr. (December 2004).

47. The Israeli government expressed its willingness to sign individual BITs with South Korea's conglomerates Samsung and LG in 2005, in addition to the already existing state-state investment treaty between the countries, in order to increase their investments in Israel. Clearly, this governmental policy reflects the confusion between a bilateral investment treaty between states and an Israeli governmental contract that includes company-specific investment incentives linked to the investment in Israel. *See* Kim Sung-jin, *Israel seeks investment treaty with Chaebol*, KOREA TIMES, January 18, 2005, *available at* http://www.bilaterals.org/spip.php?page=print&id_article=1205.

ventures and technology cooperations.[48] Israel is using BITs to foster such investments, and has already signed such agreements with China, India,[49] South Korea, and other Eastern European countries, where it has strong economic interests. For that reason, Israeli officials take the position that Israel should be interested in signing investment treaties with Russia, Singapore, Brazil, Chile, and other South American countries that would expose Israeli investors to significant export growth potential.[50]

D. Political Preferences and Budget Constrains

Since government funds are usually limited, another factor considered by the Israeli government in its BIT policy is the level of political importance of the treaty, in addition to the economic impact. Several developing countries have actively initiated BIT negotiations with Israel, believing an investment treaty with a strategic country like Israel may improve their diplomatic and economic position in the international arena.[51] Even so, Israel has a relatively low interest in some of these developing nations and does not enter into negotiations unless it gets an official request from the other party.[52] These proposed BITs negotiations are perceived by the Israeli government as an unnecessary use of valuable resources.[53]

In spite of this policy, the Israeli government tends to use investment treaties as a political 'carrot' when a diplomatic mission is visiting Israel and there is a need, or momentum, for a

48. Chalamish, *supra* note 1, at 312.

49. Israel-India diplomatic and economic relations had a special importance in Israel foreign policy. Protection against nationalization and expropriation in India caused the Israeli government to initiate BIT negotiations with India in 1994, which subsequently led to an agreement in 1996. *See* Memorandum from Int'l Dep't, Ministry of Fin. of the State of Isr., on Basic Principles with Respect to Bilateral Investment Agreements, Section F (Apr. 12, 1994) (on file with author).

50. Memorandum from Int'l Dep't, Ministry of Fin., Gov't of Isr., on Work Plan for Fiscal Year 2003, 15 (on file with the author).

51. This is the motive behind recent applications from Central American countries, such as Guatemala, to initiate BIT negotiations with Israel. Interview with Hadassah Greenberg, Deputy Dir. Treaties Dep't, Ministry of Foreign Affairs, Gov't of Isr., in Jerusalem, Isr. (Dec. 2004).

52. *See* Boneh, *supra* note 26, at 57.

53. Admon Interview I, *supra* note 18.

substantial agreement to be signed.[54] The BIT between Israel and Mongolia serves as a good example of this practice.[55] However, the economic significance and the actual results of such agreements remain somewhat questionable.

E. Summary

Due to new geopolitical challenges and economic developments, protecting Israeli investments in the developing world has been guiding the Israeli administration since the early 1990s, when negotiating and signing BITs became a significant phenomenon in the international economic community. Although fostering investment inflows into Israel and other diplomatic motives also play a certain role in the BIT process, protecting investments under threat and providing effective remedies remain the central focus of Israel's BIT strategy. This strategy has shaped the textual and structural nature of Israeli BITs over the years, which in turn reflect and promote such a strategy. The following sections will describe the reasons for, and the development of, the structure and the text of Israeli BITs as a result of the evolving strategy discussed above. The discussion takes place in light of a proposed new model, and in comparison with both similar and different trends in other legal regimes.

IV. THE NEW ISRAELI DRAFT MODEL BIT-HISTORY AND DEVELOPMENT

Bilateral investment treaties are typically drafted based on existing models. The models are very similar to each other as they share similar sources[56] and similar substantive rights and

54. *See* Work Plan for Fiscal Year 1998, § 1(c) (Isr.) (on file with author). The following countries were identified for this purpose: Uruguay, Venezuela, Bolivia, Macedonia, Serbia, Croatia, Mongolia, Azerbaijan, Kyrgyzstan, and Ghana.

55. During the Mongolian mission visit to Israel in 2003 the parties signed a BIT as part of the parties' attempt to normalize diplomatic and economic relations without a concrete demand to encourage investments in Mongolia or to protect current and potential Israeli investors there. *See* Agreement Between the Government of the State of Israel and the Government of Mongolia for the Reciprocal Promotion and Protection of Investments, Isr.-Mong., Nov. 25, 2003, *available at* http://www.mfa.gov.il/mfa/usercontrols/TreatFile.aspx?SAFA=2&AMANA=1905-A [hereinafter Israel-Mongolia BIT].

56. For example, the treaties of friendship, commerce and navigation that were aimed to establish closer economic and cultural ties between allies in the second half of the 19th century. *See* McLachlan, *supra* note 4 at 26.

obligations included in the treaty,[57] all of which frequently reflect customary international law in the field. Since the first Israeli investment treaty between Israel and Germany,[58] Israel has consistently used a draft model investment treaty (the "Old Model" or "Old Israeli Model").[59] This was based on already negotiated or signed investment treaties worldwide, even though the surrounding legal and economic circumstances have changed dramatically over the years.

In April 2000, the Israeli government decided to reevaluate the Old Model. This was done by examining past experiences of Israel and other countries utilizing BITs and by looking at recent developments in international investment law, including arbitral cases and customary law. There was a growing need to provide drafting solutions to problems that emerged in treaty interpretation practice. Recent macroeconomic trends in the global economy and the Israeli market also called for reassessment of the Old Model.

Hence, to propose a new model, a cross-governmental team, composed of the Ministry of Finance, the Ministry of Justice, and the Ministry of Foreign Affairs members was established to assess the Old Model from economic, legal, and diplomatic perspectives. It was also expected that the new model would solve substantial drafting problems and anticipate future dilemmas. After several years of extensive work, the "New Model" was approved by the Israeli administration in the beginning of 2004, consequently allowing BIT negotiations to begin and 'frozen' negotiations to recommence.[60] The next section will discuss in more detail some of

57. *E.g.*, national treatment and most-favored-nation, fair and equitable treatment and investor-state dispute settlement resolution. *Id.* at 30.

58. The Treaty between the Government of the State of Israel and the Federal Republic of Germany concerning the Encouragement and Reciprocal Promotion and Protection of Investments was signed on June 24, 1976, and entered into force temporarily on August 28, 1980. *See* Israel-Germany BIT, *supra* note 29. However, the investment treaties movement already started in 1959 by the US-Pakistan treaty, which has been followed by a wave of agreements that shaped the first Israeli model.

59. Israeli Model Bilateral Investment Treaty (on file with author) [hereinafter Old Model BIT].

60. The Israeli government deliberately froze its negotiations with several countries, including the Philippines, in order to renew them based on the New Model. However, in cases where the negotiations were in an advanced stage, Israel avoided restarting the negotiations and preferred to continue the negotiations based on the Old Model. This was the case with Mongolia and Ethiopia, with which Israel recently signed BIT agreements

the main reasons that led to the reexamination of the Old Model, while a later section will examine the potential consequences of the modifications in the New Model.

A. The New BITs—A New Global Trend

Around the year 2000, several countries realized that recent developments in international investment law might have made parts or all of their existing BITs somewhat obsolete. This required a closer look at the structure and content of BITs used for previous negotiations in light of the changes that had occurred. In many cases, these nations discovered that a particular drafting did not follow recent arbitral decisions made by international tribunals, did not appear to be in the best interest of a specific country, or did not reflect a cohesive governmental strategy.[61] Moreover, they expressed the need to add certain new provisions that had not been included in the model treaty but reflect new trends and concepts in public international law.

In addition, several governmental and non-governmental organizations have released new drafts of the model BIT, which better protect the interests of developing countries and integrate human rights elements into the treaty.[62] These organizations claimed that investment treaties protect foreign investors without supporting development in local host communities.[63] As a result, several forums were created in order to facilitate a dialogue among legislators from various countries and non-governmental organizations to examine the feasibility of integrating certain provisions of the NGOs' proposals into BITs.[64]

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based on the Old Model. Memorandum from Ministry of Foreign Affairs, Gov't of Isr., Treaties Dept. on Status of BITs (August 20, 2003) (on file with the author).

61. *See* U.N. Conference on Trade and Development [UNCTAD], Research Note, *Recent Developments in International Investment Agreements*, 6, U.N. Doc. UNCTAD/WEB/ITE/IIT/2005/1 (Aug. 30, 2005). For instance, recent investment jurisprudence expended the most-favored-nation principle to include procedural rights within the treaty. Most draft models BITs do not include any exceptions for procedural rights despite the resistance of part of the legal community to include them.

62. One of these drafts was published by the International Institute for Sustainable Development, a well-regarded Canadian research institute in April 2005. Full text of the draft is *available at* http://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf.

63. *See, e.g.*, IISD Model Agreement, *supra* note 8 at iii.

64. United Nations Conference on Trade and Development (UNCTAD) was an important player in facilitating such a dialogue in developing countries to strengthen the development component of the text of the bilateral investment treaty.

Furthermore, several governments explored the possibility of integrating investment incentives into existing draft BITs. In fact, this proposal offers to combine two traditional treaties, a bilateral investment treaty and a tax treaty, in order to create an inclusive investment treaty that bilaterally governs direct investment between two states.[65]

As a result, several new models have been created. The most influential model in this field of law, the U.S. 2004 draft model BIT, has been designed as part of this global wave and was published in February 2004.[66] The New Israeli Model, which was released in light of the aforementioned global trend, faced some of the same issues the U.S. 2004 Model BIT struggled with.

The U.S. 2004 Model BIT will serve as a point of reference to analyze the process underlying the Israeli transition from the Old Model to the New Model because it aims to implement recent developments in investment treaty jurisprudence, offers several drafting solutions, and introduces innovative arbitration concepts.

B. Continuing Violations of Former Treaties—The National Treatment Principle

Several ongoing discrimination practices of the Israeli government that block foreign investment in certain industries or favor Israeli investors over foreign investors once an investment is made, indicate that Israel is potentially in constant violation of the investors' protection standards in its BITs. These include, *inter alia*, anti-discrimination provisions. The foreign investors' community has expressed its dissatisfaction with the current legal regime in several forums. As a result, the Israeli Attorney General recommended reexamination of the Old Model and development of a new one that will follow Israel's investment policy and national commitments with respect to investors' protection standards.[67]

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65. For the importance of tax coordination in the global markets, *see generally* Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1573-1676 (2000).

66. Treaty Concerning the Encouragement and Reciprocal Protection of Investment, *available at* http://www.ustr.gov/sites/default/files/U.S.%20model%20BIT.pdf.

67. Admon Interview I.

The national treatment principle, which is a pillar of modern bilateral investment treaties,[68] has not been strictly followed by existing practices in Israel. The principle requires that the host country treats investors or investments no less favorably than it treats its own national investors, or investments made by them.[69] Similar to other developing countries,[70] Israel had recognized the limited financial resources available to its own national corporations compared to foreign multinational corporations. In order to give a boost to certain local industries, Israel prohibited foreign corporations from competing in those industries and excluded them from grants and subsidies available to its own nationals. Although the majority of these practices have been eliminated as Israel became a more market-based economy in the last several decades, some are still in place.

A model investment treaty should be sensitive to this tension, and the reevaluation of the Old Israeli Model did take it into account. The fact that many of the above mentioned investment restrictions prevent certain investments from entering Israel does not, in and of itself, violate the national treatment principle of investment treaties, since the national treatment principle only applies once an investment is already made. Israel continues to hold a 'post-establishment' policy,[71] which protects an investment against discrimination after it has already been established.[72] Since market liberalization is one of the common goals of modern BITs, there is room for discussion as to whether Israeli BITs actually serve this goal through this policy, and whether a revised model should follow a 'pre-establishment' approach.

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68. *See, e.g.*, MCLACHLAN, *supra* note 4, at 251-54 (discussing the importance of the national treatment principle and its interpretation in investor-state arbitration procedures).

69. *See id.*

70. UNITED NATIONS CONFERENCE ON TRADE AND DEV. [UNCTAD], BILATERAL INVESTMENT TREATIES IN THE MID-1990S, 64-65 U.N. Doc. UNCTAD/ITE/IIT/7, U.N. Sales No. E.98.II.D.8 (1998).

71. Organization of American States dictionary of trade terms will be used to define "post-establishment" http://www.sice.oas.org/dictionary/IN_e.asp

72. Israeli officials are currently debating whether Israel should include 'pre-establishment' investment treatment in its BITs based on the new Japanese model, which was implemented in the Japan-South Korea Bilateral Investment Treaty. For the Japanese BITs and investment liberalization provisions. see *Japan Grows Positive on Bilateral Investment Treaties*, JAPAN ECON. REV., Feb. 15, 2004, at 3.

In general, the Old Model of the Israeli BIT adhered to the broad language of the national treatment principle.[73] Originally drafted in the 1960's when the BITs movement had just begun, the text of the Old Model reflected the development of the open-market policy. Yet even then, Israel conducted several discriminatory practices and other exceptions to the national treatment standard as applied to existing investments. Although Israel encouraged foreign investment through an open door and equal treatment policy,[74] certain restrictions were imposed. As a result, when Israel has negotiated BITs that accepted a broader interpretation of the national treatment provision than it did itself, there was a potential for serious disagreement. The recent negotiation with Mexico, which pushes for a NAFTA-type BIT model,[75] is a good example for such difficulties.

Consequently, Israel's discriminatory policy has an impact on the evolving investment treaty model and long-term planning of BIT negotiations in Israel, while defining the scope of national treatment protection in various agreements. Indeed, the New Model suggests a narrower legal definition for the 'national treatment' obligation than the Old Model, accompanied by specific and general exceptions.[76] However, a careful examination shows that Israel replaced the exceptions list of the Old Model with a new general provision.[77] Moving forward, the discussion will turn to the development of the national treatment protection in detail, within the Israeli investment law context.

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73. *Compare* Old Model BIT, *supra* note 59, art. 3 *with* BILATERAL INVESTMENT TREATIES IN THE MID-1990S, *supra* note 70, at 58-59.

74. In many cases Israel even gives foreign investors additional controversial grants and tax benefits in order to attract them to invest in Israel. In the case of land expropriation, foreign investors unofficially receive a higher compensation than Israeli nationals. While Israeli nationals receive between 70 and 80 percents of the market value of the land, foreign investors can get up to 100 percents, according to Minister of Finance unofficial concession. Interview with Mr. Berris, Deputy Gen. Counsel, Ministry of Fin., the Gov't of Isr., in Jerusalem, Isr. (Dec. 2004).

75. For the current status of these negotiations with the Mexican government, *see* Memorandum from Ministry of Foreign Affairs, Gov't of Isr., Bilateral Investment Treaties – Status (Jan. 30, 2005) (on file with author).

76. Article 7 of the New Model includes a security interest exception and other general exceptions related to international commitments in international agreements, such as tax, trade, IP and former investment treaties. *See* Israeli Model Bilateral Investment Treaty (on file with author) [hereinafter New Model BIT].

77. *Compare* Old Model BIT, *supra* note 59, art. 7 *with* New Model BIT, *supra* note 76, art. 7.

C. Political Changes—Post September 11 Era

The September 11 terrorist attacks on the United States reshaped multiple legal areas worldwide. Western nations developed an array of new legal tools to combat terrorism and old regulations necessarily adjusted to the new reality. Israel, which was subject to terrorism long before the September 11 attacks, was no exception. The newly-formed Department for International Agreements and International Litigation in the Israeli Ministry of Justice reviewed past international agreements and newly negotiated ones in light of new international law and Israeli foreign policy,[78] which was influenced by global security trends. Thus, some modifications have been made to the Old Model as a response to the security aspects of foreign direct investment.

The dominant example is the new Article 7, Section 1, of the New Model that deals with national security interests.[79] The New Model supports admission of foreign investment as a general rule, and like many other international investment instruments, also includes exceptions to the national treatment and most-favored-nation standards in order to protect certain economic sectors or address public policy concerns.[80] The Israeli government followed several other investment treaty models, which include a separate national security exception that allows the parties to take

78. For a detailed description of the responsibilities of this department, *see* The Department for International Agreements and International Litigation and the Foreign Relations Division, http://www.justice.gov.il/MOJEng/The+Department+for+International+Agreements+and+International+Litigation+and+the+Foreign+Relations+D/ (last visited Feb. 8, 2010). The fact that several different governmental ministries and departments are involved in the process of BITs making raises serious questions about which entity has the authority to negotiate these agreements and what is the status of their legality. *See* Letter from Zvi Tene, Israeli Ministry of Foreign Affairs, to Dir. Gen. of the Ministry of Fin. (Apr. 6, 1998) (stressing the Ministry of Foreign Affairs' exclusive authority to sign and ratify international agreements, although several governmental bodies can participate in the negotiation process) (on file with author).

79. New Model BIT, *supra* note 76, art. 7.

80. Thomas Pollan's study of regulation of FDI admission and its exceptions reveals two kinds of exceptions. First, economic sectors, which are exempted from international competition in order to develop and protect infant national industries. Second, public policy exceptions, which commonly include security, public order, health and life, public morals and culture. *See* THOMAS POLLAN, LEGAL FRAMEWORK FOR THE ADMISSION OF FDI 199-214 (Eleven International Publishing 2006).

discriminatory security measures.[81] These measures are specifically essential in times of conflict, but they are frequently used as preventive measures against existing and potential threats to national and international security. The exception and its limitations will be further discussed later in this article.

D. The Real Impact of Bilateral Investment Treaties

While our discussion so far has focused on the implications and potential benefits of investment treaties, the costs of bilateral investment treaties should not be ignored. Planning, negotiating, implementing, and enforcing BITs require government expenditure of significant human and financial resources.[82] While some BITs are negotiated in a relatively short time frame with no significant attention to future implementation or enforcement, many other treaties require long and extensive cross-border negotiations and thorough inter-governmental implementation.[83] An effective treaty will also lead to binding legal procedures, through which a signatory government will have to defend itself in a direct investor-state litigation brought by foreign investors who are protected by the BIT. All these governmental functions involve valuable public resources that can otherwise be channeled to many other public needs.[84] In addition to these economic costs, investment treaties involve political costs as they force developing countries to trade their sovereignty for a commitment to be subject to international investment regulation and investment arbitration.[85] In order to deal with the 'credible commitment' problem, according to which developing governments may expropriate an investment once it is sunk, they limit their legislative and local judicial powers to signal a commitment to

81. New Model BIT, *supra* note 76, art. 7 ("Either Contracting Party may take measures strictly necessary for the maintenance or protection of its essential security interests.").

82. *See* Alceves, *supra* note 34, at 244.

83. This is many times the case when the BIT has only a symbolic value and serves a diplomatic purpose. A good example will be the bilateral investment treaty with Mongolia discussed above.

84. Alceves, *supra* note 34, at 244.

85. More on the notion of trading sovereignty for international commitments, *see* Wenhua Shan, *Is Calvo Dead?*, 55 AM. J. COMP. L. 123 (2007).

protect foreign investments in the future and increase foreign direct investment inflows.[86]

The substantial costs associated with BITs raise the questions of whether BITs actually promote foreign investment and increase FDI flows into the host state, and if an investment treaty is the most cost-effective international legal tool to achieve the goal and desired benefits.[87]

The Israeli cross-functional team, which had to evaluate the Old Model and existing BITs for the purpose of proposing the New Model, also considered the impact of BITs and their cost-effectiveness as part of its analysis.[88] However, no empirical study has been conducted, by the team or any other governmental agency, which examines the actual growth of FDI to or from an individual country as a result of signing a BIT with that country, the aggregate impact on FDI inflows under the BITs regime, or whether a BIT is a cost-efficient tool to protect foreign investors in Israel.[89] Nevertheless, the conducted interviews demonstrate that the cross-functional team, the current leadership of the international department at the Ministry of Finance, and the Israel Export Insurance Corp. Ltd (ASHRA),[90] are all well aware that the effectiveness of the treaties is questionable.[91] Thus, the government likely recognizes it should carefully prioritize the

86. *See id.*

87. Bilateral investment treaty is not the only instrument to protect foreign investment. Other common alternatives include an investment contract with the host state which provides commitment to protect the investment and to send any future disputes to arbitration, political risk insurance policy that is usually subsidized or administrated by the home country and offers a full compensation, and local national laws that protect foreign investors. For an overview of the various legal instruments to protect foreign investment, *see* SHERIF H. SEID, GLOBAL REGULATION OF FOREIGN DIRECT INVESTMENT 33-62 (Ashgate Publishing Limited 2002).

88. Interview with Mr. Berris, Deputy Gen. Counsel, Ministry of Fin., the Gov't of Isr., in Jerusalem, Isr. (Dec. 2004); Interview with Mr. Mayor Admon, Int'l Dep't, Ministry of Fin., the Gov't of Isr., in Jerusalem, Isr. (Dec. 2004).

89. In fact, the author is not aware of such comprehensive study of BITs conducted by any government so far.

90. ASHRA is a government-owned lon-term political-risk insurance entity. As of today, ASHRA is refusing to take into account bilateral investment treaties as one of the variables to be included in its insurance premium calculation. However, following the government's request, ASHRA is in the process of evaluating the potential impact of BITs on insurance premiums. Memorandum from Int'l Dep't, Ministry of Fin., the Gov't of Isr. on Bilateral Investment Treaties 2007-2806 (Nov. 20, 2007) [hereinafter *Bilateral Investment Treaties*].

91. Admon Interview I, *supra* note 18.

schedule of countries with whom Israel would be interested in signing a BIT, and protect Israel's interests during BIT negotiations.[92] A discontinuation of the BIT regime in Israel is not a real option currently, despite its questionable impact due to the global wave of these treaties. Hence, a discussion on a broader level regarding the effectiveness of BITs is warranted.

Empirical studies and theoretical discussions about whether BITs actually work have recently fostered a lively academic debate.[93] Academics have not yet paid much attention to the significant macroeconomic costs of such treaties. In general, economic analysis entered the field of international law in a slower, more gradual manner than it did into other legal fields. Yet, it is definitely a growing phenomenon.

The existence of a BIT as an investment protection tool is one of the elements considered in investment decisions.[94] However, recent research showed that BITs only play a minor role in such decisions[95] and, in fact, most executives in multinational corporations are unaware of BITs and their implications when investment allocations are made.[96] Several empirical studies, using different sets of assumptions and models, recently reached conflicting and ambiguous results with respect to the correlation and causation between FDI levels and bilateral investment treaties.[97] Accordingly, while Eric Neumayer and Laura Spess

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92. *Id.*

93. For the growing impact of economic analysis on international law, *see generally,* JACK L. GOLDSMITH & ERIC A. POSNER, THE LIMITS OF INTERNATIONAL LAW 138-39 (Oxford University Press, Inc. 2005); Jeffrey L. Dunoff & Joel P. Trachtman, *Economic Analysis of International Law*, 24 YALE J. INT'L L. 1, 28-33 (1999); Symposium, *Rational Choice and International Law*, 31 J. LEGAL STUD. S1 (2002); Alan O. Sykes, *The Economics of Public International Law* (Chi. Working Paper Series, John M. Olin Law & Econ. Paper No. 216, 2004), *available at* http://ssrn.com/abstract=564383.

94. The common formula in the economic literature is FDI=f[BITs(+); M(+); G(+); E(+), I(-); W(+); R(-); CF(?)]. *See* Boneh, *supra* note 26, at 55.

95. *See, e.g.*, Bilateral Investment Treaties in the Mid-1990s, *supra* note 70.

96. WORLD BANK, WORLD DEVELOPMENT REPORT 2005: A BETTER INVESTMENT CLIMATE FOR EVERYONE 177 (The World Bank 2005) (according to the report, many investors may not be aware of existing BITs when they make locational decisions and may in fact "remain oblivious until some issue arise when its provisions may be relevant.").

97. *See* Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain,* 46 HARV. INT'L L.J. 67 (2005); Tim Büthe & Helen V. Milner, The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through Policy Commitment via Trade Agreements and Investment Treaties (Aug. 20, 2004) (unpublished manuscript, *available at* http://www.allacademic.com/meta/p_mla_apa_research_citation/0/5/9/8/5/p59852_index.ht

showed in 2005[98] that developing countries that have signed more BITs are likely to receive more FDI in return,[99] Jason Yackee used a slightly different analysis. Yackee brought forth counter evidence showing that BITs are actually statistically significant predictors of FDI share only for low-risk countries and that in some cases it is impossible to say that BITs have any positive marginal effect that is statistically significant.[100]

While the empirical results are conflicting, several theoretical studies come to the conclusion that a 'race to the bottom' is the engine behind the BITs. This hurts the sovereignty of developing nations. Accordingly, a developing country will sign a BIT when its capital-importing competitor has also done so.[101]

Israel's policy to conclude BITs with developing countries based on both political and economic self-interest can be partially supported by some of the aforementioned studies. In a similar economic framework to aid allocation among nations, Eric Neumayer showed how developed countries sign BITs with countries where they have special economic or political interests.[102] The host state's need for development is also taken into account. Indeed, several least developed countries signed BITs with Israel

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ml); Peter Egger & Michael Pfaffermayr, *The Impact of Bilateral Investment Treaties on Foreign Direct Investment*, 32 J. OF COMP. ECON. 788-804 (2004); Kevin P. Gallagher & Melissa B.L. Birch, *Do Investment Agreements Attract Investment? Evidence from Latin America*, 7 J. WORLD INV. & TRADE, 961, 961-74 (2006); Jennifer Tobin & Susan Rose-Ackerman, When BITs Have Some Bite: The Political-Economic Environment for Bilateral Investment Treaties (Nov. 14, 2006) (unpublished manuscript, on file with the Yale Law Journal, *available at* http://www.law.yale.edu/documents/pdf/When_BITs_Have_Some_Bite.doc); Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit... and They Could Bite* (The World Bank, Working Paper No. 3121, 2003), *available at* http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2003/09/23/000094946_03091104060047/Rendered/PDF/multi0page.pdf.

98. Eric Neumayer & Laura Spess, *Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?*, 33 WORLD DEV. 1567, 1567-85 (2005).

99. *Id.* at 1583 (according to Neumayer and Spess' study, a developing state that signs a large number of BITs might expect to see its FDI inflows increase by up to 93%).

100. Jason Webb Yackee, *Do BITs Really Work? Revisiting the Empirical Link between Investment Treaties and Foreign Direct Investment*, U. WIS. L. SCH. LEGAL STUD. RES. PAPER SERIES, Paper No. 1054 (Oct. 2007), *available at* http://ssrn.com/abstract=1015083.

101. *See, e.g.*, Andrew T. Guzman, *Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639 (1998).

102. Eric Neumayer, *Self-Interest, Foreign Need, and Good Governance: Are Bilateral Investment Treaty Programs Similar to Aid Allocation?*, 2 FOREIGN POL'Y ANALYSIS 245, 245-67 (2006), *available at* http://www3.interscience.wiley.com/journal/118600496/issue.

over the years, such as the Democratic Republic of Congo (former Zaire) and Ethiopia.[103] Moreover, according to Neumayer, good governance of the host country is not a factor in the capital-exporting country's (or home state) decision to sign a BIT. This explains why several Israeli BITs with countries lack the protection of democracy and human rights. A closer look at Neumayer's results shows that geographical and cultural proximity, as well as the size and the level of education of the target developing state, are also considered by the developed world.[104] These conclusions can explain the wave of Israeli BITs with the larger and better-educated countries within Central and Eastern Europe since the early 1990s, with which Israel also shares close geographical and cultural ties.

In sum, several theoretical and empirical studies can explain why the Israeli BIT policy developed as an economic policy even though the statistical data which does exist is too limited to draw general conclusions.[105] This is mainly based on Israel's need to protect its own nationals in large developing economies, while also strengthening political ties with those foreign economies.

The legal and economic literature has not yet provided any comprehensive explanation as to why certain developed countries sign more BITs than others, or the reason for the existing timeline. The impact of the above-mentioned empirical studies on various governments' motivation to initiate and sign investment treaties has yet to unfold. In any case, the conclusions and their limitations are part of the reevaluation of the Israeli BIT model, and are continuously being considered by the Israeli administration.

This section looked at some of the main rationales behind the Israeli government's review process of the Old Model and existing BITs. It examined its decision to adopt the New Model in 2004, taking into account its emerging BITs policy, which has been adapted to the new economic and legal factors discussed earlier.

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103. *See id*; *see also* Agreement Between the Government of the Federal Democratic Republic of Ethiopia and the Government of the State of Israel for the Reciprocal Promotion and Protection of Investments, Nov. 26, 2003, http://www.unctad.org/sections/dite/iia/docs/bits/ethiopia_israel.pdf [hereinafter Ethiopia-Israel BIT].

104. Neumayer, *supra* note 102, at 254.

105. It is important to note that all existing empirical studies have used a larger number of bilateral investment treaties, using treaties from multiple countries and over several decades.

Before conducting an overview of the structure and text of the Israeli BIT, the next section will provide the necessary background by first reviewing the existing BITs practice in Israel since its inception.

V. BILATERAL INVESTMENT TREATIES IN ISRAEL-BASIC FACTS & FIGURES

Structural reforms, economic liberalization, and Israeli investments in newly evolved foreign markets all contributed to the Israeli BIT policy. Between 1976[106] and 2004, Israel signed 34 agreements, four of which have not been ratified as of yet. Most of these agreements were signed with developing countries and emerging economies, where Israel had strong, rising investment interests.[107] In the few agreements that were signed with countries in which Israel had no significant investment interest, the agreements served either specific strategic or diplomatic goals, or were part of a broader framework of international economic agreements (trade, double-taxation, etc). The vast majority of these agreements do not reflect reciprocal investment relations and they strengthen Israel's status as a state in transition from a developing to a developed economy.

With the exception of some recent agreements,[108] almost all Israeli BITs were signed between 1991 and 2000 as a result of geo-political changes in Europe and Asia, which furthered accessibility into new Eastern European markets and diplomatic developments in the Middle East.[109] Indeed, many of these countries belonged to the former Soviet Union.[110] Only after the fall of the U.S.S.R. did these countries open their local industries to Israeli investments

106. The first Bilateral Investment Treaty was between Israel and Germany. This treaty was signed on June 24, 1976 and entered into force on August 28, 1980. The future status of the treaty is under consideration in the German and Israeli governments. Israel-Germany BIT, *supra* note 29.

107. *Bilateral Investment Treaties*, *supra* note 90.

108. Only four agreements have been signed since the year 2000. Two of them, the BITs with South-Africa and Serbia-Montenegro, are already based on the New Model mentioned above. The other two, with Ethiopia and Mongolia, are based on the Old Model since the New Model was adopted after some substantial negotiations already took place between the parties.

109. *See supra* Part II.A.

110. Andrej Kreutz, *Post-Communist Eastern Europe and the Middle East: The Burden of History and New Political Realities*, 21 ARAB STUDIES QUARTERLY, Spring 1999, at 1, 5.

and accommodate foreign direct investment. The Middle East peace process has significantly improved Israel's foreign relations with several Eastern European countries that traditionally had close ties with Arab countries in the Middle East.[111] Israel initiated BIT negotiations with these countries with the dual purpose of encouraging Israeli investments abroad to position Israel as a meaningful player in global markets, and to ensure investment protection in these newly born and unstable economies. A transition period to market economy and rule of law called for the use of international legal tools to ensure investment protection, which included BITs.

Although it is difficult to determine the actual impact of those BITs fostering Israeli investments in Eastern Europe since the collapse of the Soviet Union, at least the position of Israeli investors in Eastern Europe is now recognizable. In some Eastern European countries, Israelis are considered amongst the largest investors in certain industries. They enjoy the protection of the signed bilateral treaties, in addition to the efforts of these governments to strengthen the rule of law and governmental institutions in these countries.[112] For example, in Romania, which officially joined the European Union on January 1, 2007, 2.5 percent of the companies registered with foreign capital are Israeli-owned.[113] It is important to note that while there is a mutual economic effort from those Eastern European countries, they also generate significant amounts of new capital and target the Israeli economy. This trend suggests that reciprocal economic relations between these unbalanced economic powers are indeed plausible.[114] It also adds another angle to the potential success of

111. *See id.* at 1 (discussing the relationships between the Arab world and East Europe following the collapse of the Soviet Union).

112. *Id.* at 5.

113. They represent 300 million U.S. dollars of direct investments in Hungary, in addition to 500 million U.S. dollars of investments in defense and engineering projects. However, more than one billion U.S. dollars are currently invested in Hungary indirectly through European entities driven by international tax considerations. For an economic analysis prepared by the Israel Ministry of Industry, Trade and Labor, *see* ISRAEL MINISTRY OF INDUS., TRADE AND LABOR, ECONOMIC ANALYSIS OF ROMANIA, http://moit.gov.il/NR/rdonlyres/6151549D-AF7D-43BD-8BA1-7D23AB8F54D1/0/skira_romania.doc.

114. The majority of this capital comes from Russia. However, Israel-Russia BIT negotiations have not been successful as of yet due to several disagreements on currency control and dispute resolution mechanism. Admon Interview I, *supra* note 18.

the BIT mechanism—creating a positive, investor-friendly environment. The latter is not very telling, however, as Israel already provides a high level of legal protection to its foreign investors,[115] and this component does not play a major role in Israeli BIT policy.[116] A careful examination of governmental reports and interviews conducted by the author reveals the following with respect to existing BITs and the current Israeli policy towards negotiating future BITs.

First and foremost, Israel does not tend to sign BITs with countries that, at the time of signing, are developed countries. It instead uses these agreements to protect Israeli investors abroad in emerging and unstable economies, because such protection is simply unnecessary in developed countries. Nevertheless, the government has been reassessing the New Model, which was designed in 2003, in order to determine whether the New Model can be adjusted and extended to developed countries.[117] A future model may adopt several North American models and include investment liberalization provisions. These provisions open new economic sectors in developed countries to foreign investments, or provide investment incentives for certain investors in under-invested industries or geographical areas. Because investment treaties in Israel have traditionally followed the European models, which do not include such provisions, it is not surprising that Israeli BIT policy does not currently include negotiating investment treaties with developed economies.

Second, membership in multinational organizations based on high macro-economic standards is a good indication for the legal and economic strength of the country's economy, and the country's level of protection of foreign investors. Therefore, Israel does not initiate or sign BITs with Organization for Economic Cooperation and Development (OECD) member states, and recently put a halt to its negotiation with Mexico, an OECD

115. For ranking of the Israeli economy for business purposes, see THE WORLD BANK & THE INT'L FIN. CORP., DOING BUSINESS 2008 (The World Bank 2007), *available at* http://www.doingbusiness.org/documents/FullReport/2008/DB08_Full_Report.pdf [hereinafter DOING BUSINESS 2008].

116. *Bilateral Investment Treaties, supra* note 90.

117. *Id.*

member state.[118] Similarly, Israel canceled its BIT agreements with Poland and Czech Republic after they joined the European Union in 2004.[119] This raises a broader question regarding the status of BITs as bilateral agreements when one of the parties dissolves as a sovereign state and the identity of the succeeding entity is not clearly defined. For instance, the European Union and Israel are currently negotiating the future status of BITs that were signed between Israel and countries that joined the EU since the ratification of that particular BIT.[120] In that respect, multinational organizations can play a greater role than their indicator function in the BIT making process. The UN Conference on Trade and Development ("UNCTAD"), for example, aims to foster growth in the developing world.[121] It could also serve as an effective forum for Israel to negotiate and sign BITs with appropriate countries. However, the shaky political relations between Israel and UNCTAD have an impact on the current and potential use of this forum.[122]

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118. *Accord id.*; Interview with Mayor Admon, Ministry of Fin., Gov't of Isr., in Jerusalem, Isr. (Nov. 30, 2007) (providing an explanation for the status of the negotiation with Mexico) [hereinafter Admon Interview II].

119. Admon Interview I, *supra* note 18.

120. Since the EU has a separate trade and investment policy, bilateral investment treaties of member states with third parties can be either unnecessary or inconsistent. See - EU Council Conclusions on Comprehensive European International Investment Policy, 3041st Foreign Affairs Council Meeting, Luxemburg, October 25, 2010, *available at* http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/117328.pdfv (discussing EU foreign investment policy after the Lisbon Treaty); For a thorough discussion of succession of treaties in the Czechoslovakia context, see ERIC STEIN, CZECHO/SLOVAKIA: ETHNIC CONFLICT, CONSTITUTIONAL FISSURE, NEGOTIATED BREAKUP (University of Michigan Press 1997). In that case, the Czech Republic and Slovakia agreed that all treaties linked exclusively with the territory of a successor state will be inherited by that state and it was the sole responsibility of each of them individually to negotiate with the other contracting party on the question of whether or not the treaty should remain in force.

121. United Nations Conference on Trade and Development, About UNCTAD, http://www.unctad.org/Templates/Page.asp?intItemID=1530&lang=1.

122. The United Nations Conference on Trade and Development (UNCTAD) signed a Memorandum of Understanding with the Center for International Cooperation (MASHAV) of the Ministry of Foreign Affairs of the State of Israel for the Establishment of a Programme of Cooperation, which was signed and entered into force on June 16, 1998. The objectives of the Programme, according to Article 1 of the Memorandum of Understanding, are "to combine the professional as well as the operational resources of UNCTAD and MASHAV in support of national and regional development efforts of developing countries and economies in transition." *See* Memorandum of Understanding with the Center for International Cooperation (MASHAV) of the Ministry of Foreign

Third, the leading factors considered when initiating BIT negotiations are: (1) the current and expected volume and quality of trade and investment in the host country; and (2) the level of legal security and protection foreign investors can enjoy in this country. Nevertheless, while volume, type of trade and investment are easy to measure, legal instability tends to be vague and much harder to quantify.[123] Accordingly, Israeli officials fail to use an objective scale to measure legal instability. An alternative such as the several scales of government corruption designed by international organizations such as the OECD or the World Economic Forum could be used for this matter. Another option could be ASHRA's political and economic risk classification table.[124]

The Israel Export Insurance Corp. Ltd. ("ASHRA") is fully owned by the Israeli government. It encourages Israeli exports by insuring medium and long term export credit transactions, of one to ten years, with investments abroad.[125] This state-owned company is focused on political risks, while another private company is providing supplemental insurance against economic risks.[126] ASHRA's current policy, unlike other rating agencies, does not use BITs as a factor in its own ranking.[127] Although ASHRA is reexamining its policy and is still involved in the governmental BIT process, the Israeli government is not using its ranking as an authority for the BIT process. Although BIT effectiveness is questionable, it should be considered as part of the political risk calculation.

Fourth, even though investment and other economic interests in a foreign country are the leading motives behind BITs, diplomatic and national interests also influence Israeli officials. In 2003, Israel signed agreements with Ethiopia and Mongolia as part of the diplomatic efforts to build relationships with these

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Affairs of the State of Israel for the Establishment of a Programme of Cooperation, June 16, 1998 (on file with author).

123. On various ways to measure legal instability, *see* Bilateral Investment Treaties in the Mid-1990s, *supra* note 70.

124. The table includes seven different levels of political and economic risks, *available at* http://www.ashra.gov.il/DisplayClassifications.asp (last visited April 17, 2008).

125. *Id.*

126. *Id.*

127. *Bilateral Investment Treaties, supra* note 90.

countries.[128] Also, Angola initiated BIT negotiations with Israel to increase the already high level of foreign investment coming from Israeli companies, but the Israeli government rejected the offer because of political constraints.[129]

Fifth, due to the geographical nature of bilateral investment treaties,[130] the Israeli government avoids negotiating with countries with unsettled borders. For example, although Israel has already signed several economic agreements with Taiwan, the current BIT negotiations between Israel and Taiwan have been frozen as a result of legal opinions that question Taiwan's borders. The close diplomatic relationship between Israel and China, which is at a higher priority, also played a role in that decision.[131]

Sixth, Israeli government policy supports agreements with trade blocks in order to strengthen economic relations with countries that share common interests.[132] Countries also tend to negotiate and sign agreements more easily if their neighbors have already signed similar agreements in the past. Israel signed BITs with several non-EU European countries that enjoy special relationships with the EU through some of its programs, without being obliged by EU procedural mechanisms. These include the European Neighborhood Policy ("ENP"), Cross Border Cooperation Corporation, Barcelona Process, and others.[133] As such, Israel has recently expressed an interest in Macedonia and is

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128. The Israel-Mongolia BIT was signed on November 25, 2003, and the Israel-Ethiopia BIT was signed on November 26, 2003. Israel-Mongolia BIT, *supra* note 55; Ethiopia-Israel BIT, *supra* note 103.

129. The main economic interest in Angola for Israeli investors is the diamonds mining industry, which supports the rough and polished diamonds trading markets). Admon Interview II, *supra* note 118.

130. Unlike other economic agreements, most BITs cover only investments within the geographical borders of the host country. Tax treaties, on the other hand, are usually based on the residency test. Cortney M. Arnold, *Protecting Intellectual Property in the Developing World: Next Stop—Thailand*, 2006 DUKE L. & TECH. REV. 10, 10 (2006); Robert H. Dilworth, *Financing International Operations of U.S. Multinationals*, 592 P.L.I./TAX 305, 322 (2003).

131. Accord *Bilateral Investment Treaties*, *supra* note 90; Admon Interview II, *supra* note 118.

132. Dov Mishor, *Free Trade Agreements as a Vehicle to Growth: The Israeli Experience*, 3 INT'L RES. J. L. & FIN. 56, 60 (2006), *available at* http://www.eurojournals.com/IRJFE%203%206%20mishor.pdf.

133. The Serbia-Montenegro BIT was the last one to be signed. The legal department of the Ministry of Foreign Affairs is examining the status and identifying the successor of this treaty following Montenegro's independence.

about to start negotiating with Bosnia for the same reason.[134] The Israel BIT team will soon identify additional Balkan countries to initiate BIT negotiations with countries within this trade block.

Similarly, the Israeli government has given a special priority to the Central America trade block. Israel has recently initiated negotiations with Costa Rica based on Israel's growing economic interest in Costa Rica's trade potential and the strong diplomatic relations between the two countries.[135] Negotiations with Guatemala, a neighboring country with a similarly increasing economic interest, have led to a signed agreement that should soon be ratified by the Israeli government pending finalization of internal procedures.[136]

This is similar to Israel's ongoing BIT negotiations with Uzbekistan.[137] Following signed agreements with several Commonwealth of Independent States (CIS)[138] such as Azerbaijan, discussions with Uzbekistan were initiated.[139] The CIS is an international organization comprised of former soviet republics.[140] It was created on December 21, 1991 and simultaneously declared the dissolution of the Soviet Union and the independence of its members.[141] The negotiations with Uzbekistan reflect Israel's priority to negotiate BIT agreements with the remaining CIS countries and expand its economic ties with that economic block.

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134. *Bilateral Investment Treaties*, *supra* note 90.

135. Until recently, Costa Rica was the only country to have an embassy in Jerusalem along with El Salvador. Following a diplomatic pressure from Arab states, both countries announced in 2006 that they plan to move of their embassies and diplomatic missions from Jerusalem to Tel Aviv.

136. The BIT with Costa Rica has not materialized as of yet. Costa Rica, which has been simultaneously negotiating a Bilateral Trade Agreement with the United States and a Central America Free Trade Agreement with other South American countries, tried to avoid additional obligations via a bilateral investment treaty with Israel. Admon Interview I, *supra* note 18.

137. *Id.*

138. *Bilateral Investment Treaties*, *supra* note 90

139. The Israel-Uzbekistan BIT was signed on July 4, 1994 and was ratified on February 18, 1997.

140. CIS member states are: Azerbaijan Republic, Republic of Armenia, Republic of Belarus, Georgia, Republic of Kazakhstan, Kyrgyz Republic, Republic of Moldova, Russian Federation, Republic of Tajikistan, Turkmenistan (associate member only because it withdrew its full membership in 2005), Republic of Uzbekistan, and Ukraine. Commonwealth of Independent States (CIS), List of CIS States, http://cis.minsk.by/main.aspx?uid=3390 (last visited Feb. 8, 2010).

141. Commonwealth of Independent States, http://www/cisstat.com/eng/cis.htm (last visited Feb. 7, 2010).

Interestingly enough, the only cases of expropriation of Israeli investments abroad, were reported to the Israeli government in order to receive Israel's support related to investments in CIS countries.[142] Economic arrangements among CIS members have potential implications on BIT negotiations between Israel and CIS members. Russia does not want to offer Israel economic privileges similar to the ones offered to other CIS countries by using an MFN provision in a future Israel-Russia BIT.[143] Similar obstacles can emerge as Israel negotiates investment treaties with countries that belong to other blocks with internal economic arrangements.

Finally, ratifying an already-executed agreement takes an important role in the BIT governmental process, even though the passage of time makes some government officials wonder about the importance and implications of ratifying an agreement. In 2003, the Israeli government almost simultaneously ratified nine BITs signed between 1998 and 2000 as a result of joint efforts by several government agencies.[144] Most of the signed BITs that the Israeli government has not ratified will be ratified once the Israeli government finalizes internal procedures. It is more of a

142. Because these incidents did not develop to legal claims, we have no access to confidential correspondence between these investors and the Israeli government.

143. Among other controversial issues, Russia also calls for a Russian government approval for every future investment arbitration dispute, a request which has been rejected by the Israeli government. U.S. Department of State 2009 Investment Climate Statement – Russia, http://www.state.gov/e/eeb/rls/othr/ics/2009/117226.htm (last visited Feb. 7, 2010).

144. Between June 2003 and August 2003, Israel ratified the BITs between Israel and the following countries: Cyprus, Republic of Korea, Slovak Republic, Armenia, El Salvador, Croatia, Romania, Belarus, and Thailand. *Bilateral Investment Treaties*, *supra* note 90; Agreement Between the Government of the State of Israel and the Government of the Republic of Cyprus for the Reciprocal Promotion and Protection of Investments, Isr.-Cyprus, June 17, 2003, http://www.mfa.gov.il/mfa/usercontrols/TreatDetails.aspx?Id=1750-A (last visited Feb. 7, 2010);
Agreement Between the Government of the State of Israel and the State of the Republic of Croatia for the Reciprocal Promotion and Protection of Investments, Isr.-Croat., July 13, 2003, http://www.mfa.gov.il/mfa/usercontrols/TreatDetails.aspx?Id=2075 (last visited Feb. 7, 2010); Agreement Between the Government of the State of Israel and the Government of the Republic of Armenia for the Promotion and Reciprocal Protection of Investments, Isr.-Arm., June 25, 2003, http://www.mfa.gov.il/mfa/usercontrols/TreatDetails.aspx?Id=2038 (last visited Feb. 7, 2010). For a complete directory of Israeli treaties see http://www.mfa.gov.il/MFA/Treaties/Israel+Bilateral+agreements/ (last visited November 30, 2010)

technicality since there is no real issue that would prevent the BITs from being ratified.[145]

However, there are several examples that reflect the complexity of negotiating multiple treaties based on several models in different timelines. For instance, the Israel-South Africa BIT was already in the process of being ratified when the Israeli government realized there was an ambiguity with respect to the final text of the treaty.[146]

Another example of this complexity is the Israel-China BIT. This has not been ratified yet because Israel wants to cancel BITs with Hungary, Poland, and the Czech Republic before it ratifies the BIT with China. The former agreements include currency exchange provisions which allow each government to impose restrictions on currency transfer.[147] Israel has already eliminated all currency restrictions, but the inclusion of such provisions in the BITs with Hungary, Poland, and the Czech Republic will offer similar privileges to the Chinese government through the MFN mechanism, which the Israeli government is trying to avoid.[148] As mentioned before, Israel ultimately canceled its agreements with Poland and the Czech Republic after those countries joined the European Union, since there is no need for such agreements any longer.

With respect to Hungary, an economic cooperation agreement and a statement of intent on R&D cooperation was signed on February 7, 2006.[149] Israel and Hungary signed the

145. Admon Interview I, *supra* note 18.

146. *Id.*

147. Agreement Between the Government of the State of Israel and the Government of the Republic of Hungary for the Promotion and Reciprocal Protection of Investments, Isr.-Hung., May 14, 1991, http://www.mfa.gov.il/mfa/usercontrols/TreatFile.aspx?SAFA=2&AMANA=1218; Agreement Between the Government of the State of Israel and the Government of the Republic of Poland for the Promotion and Reciprocal Protection of Investments, Isr.-Pol., May 22, 1991, http://www.mfa.gov.il/mfa/usercontrols/TreatFile.aspx?SAFA=2&AMANA=1219; Agreement Between the Government of the State of Israel and the Government of the Czech Republic for the Reciprocal Promotion and Protection of Investments, Isr.-Czech Rep., Sept. 23, 1997, http://www.mfa.gov.il/mfa/usercontrols/TreatFile.aspx?SAFA=2&AMANA=1715-A.

148. *Id.* The most-favored-nation standard ("MFN"), which prevents discrimination among investors from different home countries, will be discussed in detail in the next section. *See infra* Part VI.C.

149. Agreement on Economic Co-operation Between the Government of the State of Israel and the Government of the Republic of Hungary, Isr.-Hung., Feb. 5, 2006, *available*

agreement after Hungary became an EU member, and was aimed at preserving Israel's bilateral relationship with Hungary outside of the EU institutional structure.[150] Because the economic cooperation agreement between Israel and Hungary contains investment provisions, the BIT with Hungary can be canceled as soon as the economic cooperation agreement is ratified, and it paves the way for ratification of Israel-China BIT by the Israeli government.[151]

To conclude, the current BIT policy has been influenced by several considerations rather than by a clear, decisive factor. On one hand, the current BIT policy gives policy makers certain discretion regarding the states with which they negotiate BITs. On the other hand, the data shows several inconsistencies,[152] calling for a clear prioritization of states that are candidates for BIT negotiations. The Israeli government, indeed, is considering shifting to such a process.[153] It also remains to be seen whether the recent reduction in Israeli BIT negotiations is a temporary or permanent phenomenon.

Although it can be explained by an existing policy, this reality can be changed dramatically by other factors. This includes the growing use of international tribunals to settle global conflicts and the increasing protectionism in many developing economies as a result of greater competition for foreign investments in times of prospective global economic downturn.[154] The next section will review in detail the structure and key provisions, both procedural and substantive, of the Israeli BITs, with a special emphasis on the New Israeli Model as the leading framework for current and future treaties.

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at http://www.mfa.gov.il/mfa/usercontrols/TreatDetails.aspx?Id=2371 (last visited Feb. 7, 2010).

150. For a press coverage describing the agreement and its main provisions, *see* Bilaterals.org, Israel, Hungary Sign Economic Cooperation Agreement, http://www.bilaterals.org/article.php3?id_article=3763 (last visited Feb. 8, 2010).

151. Admon Interview II, *supra* note 118.

152. Although this can be created by a change in the government's policy, there are several non-related factors, such as frequent changes in government personnel, which increase the level of inconsistency in the bilateral investment treaty-making process.

153. *Bilateral Investment Treaties*, *supra* note 90.

154. Andrew T. Guzman & Timothy L. Meyer, *International Common Law: the Soft Law of International Tribunals,* 9 CHI. J. INT'L L. 515, 534-35 (2009); Janet E. Kerr, *A New Era of Responsibility: a Modern American Mandate for Corporate Social Responsibility,* 78 UMKC L. REV. 327, 334-35 (2009).

VI. ISRAELI BITS- STRUCTURE AND CONTENT

Generally speaking, Israeli BITs share a consistent structure, though in some cases they use different language for specific circumstances. Both the Old Model and the New Model define investment, investor, returns, territory, and freely usable currency for the specific purpose of the treaty. All agreements then provide general statements on promotion and protection of investment, set most favored nation and national treatment obligations as investor protection standards, establish compensation mechanism for losses, set the conditions for a legal expropriation, establish repatriation of investments and returns rights, and determine the procedures available for investor-to-state and state-to-state dispute resolution. Israeli BITs also include a subrogation chapter and other general provisions, such as duration, termination, and exceptions to the treaty.[155]

This section will discuss key definitions and other procedural and substantive provisions of the New Model with special emphasis on the changes made since the Old Model, including a comparison with some international precedents. A review of several old generation Israeli BITs show that some of these treaties use a slightly different language than the Old Model itself. This paper cannot cover all of these variations, but a reference will be made whenever it is appropriate, especially when a variation has found its way into the New Model era.

A. Key Definitions—What is an "Investment" and Who is an "Investor"?

1. Which Investments are Covered by the Treaties?

Israel adopted a broad definition of "investment," aiming to include as many investments as possible within the treaty's protection scope. Since capital flows between Israel and its counterparts can be unilateral, it is Israel's interest to protect all kinds of investments made by its nationals. Increased FDI in several sectors introduced new forms of investment by allowing Israeli investors to market products or services without owning any of its assets. Thus, both the Old Model and New Model use the

155. *See* Old Model BIT, *supra* note 59. *See also* New Model, Article 1, Section 1, *supra* note 76.

general language of "*every kind of asset*,"[156] followed by a non-exhaustive list of examples. While earlier investments treaties adopted a rather narrow approach and enumerated the investments covered by the treaty,[157] modern treaties follow a broader approach and differ from each other by the way they limit the coverage. The list of assets that illustrates the term 'investment' in the New Model includes:

> (a) movable and immovable property, as well as any other rights *in rem*, in respect of every kind of asset; (b) rights derived from stocks, shares, bonds, debentures and other kinds of interests in companies; (c) claims to money, goodwill and other assets and to any performance having an economic value; (d) rights in the field of intellectual property, including patents, trade marks, geographical indications, industrial designs, technical processes, copyrights and related rights, undisclosed business information, trade secrets and know-how, topographies of integrated circuits and plant-breeders rights; (e) business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources.[158]

Although the New Model kept the "asset based" definition, it expanded the list of examples listed in the Old Model. The purpose was to adjust the Old Model to recently developed types of assets in the financial markets and the intellectual property field,[159] such as debentures and undisclosed business information.[160]

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156. Old Model BIT, *supra* note 59, art. 1, Section 1. *See also* New Model, *supra* note 76, art. 1, Section 1(a), p. 2.

157. In fact, earlier treaties did not dedicate a separate definition for 'investment' and left the question open. *See, e.g.*, Exchange of Notes Between the Government of Canada and the Government of Israel Constituting an Agreement Relating to Canadian Investments in Israel Insured by the Government of Canada Through Its Agents, the Export Development Corporation, Can.-Isr., May 1, 1972, 1972 Can. T.S. No. 15. Most Friendship, Commerce and Navigation Treaties, the predecessors of the bilateral investment treaties, do not include an 'investment' definition.

158. New Model, *supra* note 76, art. 1, Section 1.

159. The wording in the New Model includes new types of assets in Article 1(d) and adds debentures to the BIT. *See* Old Model BIT, *supra* note 59, art. 1. *See also* New Model, *supra* note 76, art. 1, Section 1(d).

160. Article 1, Section 1 of the New Model states the following: ". . . including, but not limited to . . . (b) rights derived from stocks, shares, bonds, debentures, and other kinds of interests in companies . . . (d) rights in the field of intellectual property, including patents, trade marks, geographical indications, industrial design, technical processes, copyrights and related rights, undisclosed business information, trade secrets and know-how, topographies of integrated circuits and plant-breeders rights . . . ." *Id.*

The struggle to find an appropriate definition for the term "investment" arose from the need to differentiate between trade and investment.[161] Since investment treaties derogate state sovereignty for the purpose of direct investor-state dispute resolution mechanism, it is important to limit such derogation to cases where it helps developing states increase their welfare and get a valuable kind of asset flows.[162] Other kinds of flows, such as trade in goods and portfolio investment, are not considered by many economists as welfare-boosters in the same way.[163] This rationale will help us understand the debate in literature and case law as to what should be included in treaty language and, as a result, what is the scope of its investment protection. Such understanding is necessary in order to make sure that Israeli BIT follows the welfare rationale.

The New Israeli model, similar to Article I(3) of the ASEAN model,[164] has adopted the 'illustrative list' approach. This approach uses a general broad definition following by an illustrative list, which emphasizes the kinds of investments which can potentially be included,[165] By adopting the illustrative model, the New Model has rejected two other dominant trends in investment agreements, namely, the 'exhaustive list' and the 'hybrid list' treaties. The

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161. The GATT system was the first system to officially separate the two economic fields of trade and investment. *See* Kevin C. Kennedy, *The GATT-WTO System at Fifty*, 16 WIS. INT'L L.J. 421, 485 (1997).

162. *See* Noah Rubins, *The Notion of "Investment" in International Investment Arbitration*, *in* ARBITRATING FOREIGN INVESTMENT DISPUTES: PROCEDURAL AND SUBSTANTIVE LEGAL ASPECTS 283, 287 (Norbert Horn & Stefan Kröll eds., 2004).

163. Nevertheless, 'investment' definitions in investment treaties are usually broad enough to cover both direct investments and portfolio investments. Old Model BIT, *supra* note 59, art. 1, Section 1 (". . . including, but not limited to . . . (b) rights derived from stocks, shares, bonds, debentures and other kind of interests in companies . . . .").

164. Agreement Among the Governments of Brunei Darussalam, The Republic of Indonesia, Malaysia, The Republic of the Philippines, The Republic of Singapore, and The Kingdom of Thailand for the Promotion and Protection of Investments, art. 1(3), Dec. 15, 1987, 27 I.L.M. 612.

165. The 'investment' definition of Article I(3) of the ASEAN treaty includes *"every kind of asset and in particular shall include, though not exclusively: (a) movable and immovable property and any other proper rights such as mortgages, liens and pledges; (b) shares, stocks and debentures of companies or interests in the property of such companies; (c) claims to money or to any performed under contract having a financial value; (d) intellectual property rights and goodwill; (e) business concessions conferred by law or under contract, including concessions to search for, cultivate, extract, or exploit natural resources.". Id.*

former, mostly recognized by the NAFTA[166] and some additional North American agreements,[167] defines 'investment' by a broad-yet-exhaustive list of covered economic activities, along with a negative definition that lists certain kinds of property which are *not* considered investments under the treaty.[168]

The latter model, mostly recognized by the U.S. 2004 Model BIT and U.S.-Singapore Free Trade Agreement, includes a basic broad definition and a non-exhaustive list like the New Israeli Model BIT. However, that list is interpreted by explanatory notes that narrow the broad definition by listing required characteristics for an investment to be protected by the treaty.[169]

The old U.S. model, designed in 1994 ("U.S. 1994 Model BIT" or the "Old U.S. Model"), followed a similar approach to the Israeli one. Although there are some deviations between U.S. BITs that were based on the U.S. 1994 Model BIT,[170] most of them follow a similar language. For example, the text used in the letter of submittal of the U.S. BIT with Bahrain[171] emphasizes the broad view adopted by the Old U.S. Model and subsequently by the New Israeli Model. "The Treaty's definition of investment is broad, recognizing that investment can take a wide variety of forms. . . .

166. North American Free Trade Agreement, U.S.-Can.-Mex., ch. 11, Dec. 17, 1992, 32 I.L.M. 289, 639 (1993) [hereinafter NAFTA].

167. *See, e.g.*, Free Trade Agreement, Ca.-Chile, art. G-40, Dec. 5, 1996, 36 I.L.M. 1079, 1082.

168. Under NAFTA, property which is not considered to be investments under the treaty are claims to money that arise solely from commercial contracts for the sale of goods or services, or from the extension of credit in connection with a commercial transaction. *See* NAFTA, *supra* note 166, at 1139(i).

169. Free Trade Agreement, U.S.-Sing., May 6, 2003, art. 15.1, *available at* http://www.ustr.gov/sites/default/files/uploads/agreements/fta/singapore/asset_upload_file708_4036.pdf.

170. For example, Article 1(d) of the U.S.-Jordan BIT explicitly states that *"any change in the form of an investment does not affect its character as an investment"*. This addition does not appear in all U.S. BITs and aims to solve the problem of change in incorporation of investing entity. Treaty Between the Government of the United States of America and the Government of the Hashemite Kingdom of Jordan Concerning the Encouragement and Reciprocal Protection of Investment, U.S.-Jordan, July 2, 1997, S. Treaty Doc. No. 106-30 [hereinafter U.S.-Jordan BIT], , Article 1(d).

171. Treaty Between the Government of United States of America and the Government of the State of Bahrain Concerning the Encouragement and Reciprocal Protection of Investment, U.S.-Bahr., Sept. 29,1999, S. Treaty Doc. No. 106-25, V-XVI (2000) [hereinafter U.S.-Bahrain Treaty].

The Treaty provides an illustrative list of the forms an investment may take."[172]

It is important to note that Israel does not include in its "investment" definition either "directly" or "indirectly" controlled investments, which the U.S. 1994 and 2004 BIT Models do include.[173] Since other intermediate companies or persons, including those of third countries, could gain indirect ownership or control,[174] Israel has been influenced by its security concerns and is not willing to offer investment protection in the event that a hostile entity from a third country is involved in the investment structure.[175]

As mentioned before, the U.S. 2004 Model BIT takes a different and more qualitative approach to the "investment" element. According to that view, the investment has to have "characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk."[176] In spite of the fact that this model provides an illustrative list of investment forms, it still demands that those investment forms satisfy a qualitative requirement.[177] Thus, although the list mentions debts and licenses as forms of qualified investments,[178] the comments on the text clarify these examples in light of the qualitative test.[179]

Accordingly, while bonds and other long term notes are more likely to have the necessary characteristics, immediate claims to payments following the sale of goods or services are often lacking.[180] In the same way, while many kinds of licenses will be considered investments based on their characteristics, others that

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172. *Id.*

173. U.S. 2004 Model BIT, *supra* note 27, art. 1, Section A.

174. Although not specifically defined in the treaty, control in this context usually means ownership of over 50 percent of the voting stock of a company. Many other times different arrangements will satisfy the requirement. U.S.-Bahrain Treaty, *supra* note 171, at V-XVI. ("Control is not specifically defined in the Treaty; ownership of over 50 percent of the voting stock of a company would normally convey control, but in many cases the requirement could be satisfied by less than that proportion, or by other arrangements").

175. *See* ORG. FOR ECON. CO-OPERATION AND DEV., OECD INVESTMENT POLICY REVIEWS: ISRAEL 64 (2002).

176. U.S. 2004 Model BIT, *supra* note 27, Section A, Art. 1, definition of 'investment.'

177. *Id.*

178. *Id.*

179. *Id.*

180. *Id.*

do not create any rights protected under domestic law cannot satisfy the test of the treaty.[181]

The U.S. 2004 Model BIT mechanism allows arbitrators to examine the characteristics of each investment beyond the formal structure of the investment.[182] Additional characteristics may be provided by investment arbitration cases.[183] The New Israeli Model, which offers a flexible adoption of new forms of investment through the 'illustrative model', forces arbitral tribunals to develop a test for the 'investment' requirement through a case-by-case analysis of the fundamental nature of the investment.[184] Consequently, both models can result in extensive investor-state jurisprudence, which determines the required characteristics of investment for the purposes of investment treaties. The new generation U.S. treaties' approach, however, does limit the level of uncertainty that is expected from this qualitative test.

As a matter of fact, while early investment arbitration decisions did not deal with the nature of the investment,[185] the majority of cases since then have included a thorough discussion analyzing whether the investment under consideration meets the "investment" jurisdictional requirement of the investment treaty.[186] The New Israeli Model has adopted a broad definition, which covers the investments discussed so far, and is subject to the jurisdictional interpretation developed by recent investor-state jurisprudence.[187] A potential Israel-specific jurisdictional limitation, however, can be imposed by the definitions article of the New Model. Article 1, Section 4, of the New Model, which applies protection standards to reinvestment of returns of an original investment, provides that "a change in the form of the

181. *Id.*
182. *Id.*
183. *Id.*
184. New Model BIT, *supra* note 76.
185. *See, e.g.*, Tradex Hellas SA v. Republic of Albania, 5 ICSID (W. Bank) 43 (1996).
186. *Consortium Groupement LESI-Dipenta V. Algeria* (ICSID Case No. ARB/03/08), Award, January 10, 2005, paragraph 24; *PSEG Global Inc., The North American Coal Corporation, and Konya Ilgin Elektrik Uretimve Ticaret Limited Sirketi v. Republic of Turkey* (ICSID Case No. ARB/02/5), Decision on Jurisdiction, June 4, 2004., paragraph 109. For a contradicting opinion in a recent ICSID decision see *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (ICSID Case No. ARB/03/25), Award, August 16, 2007.
187. New Model BIT, *supra* note 76.

investment or a change in the form of the reinvestment shall not affect their character as investments within the meaning of this Agreement if the change is effected in accordance with the laws and regulations of the Host Contracting Party."[188]

On one hand, this provision follows investment arbitration jurisprudence and adopts a flexible approach with respect to the tension between the form of investment and its nature.[189] On the other hand, part of this provision could potentially be interpreted, as several respondents claimed in recent arbitration cases, as a formal recognition that the local laws of the host state define and characterize investment.[190] Several investment arbitration tribunals, however, have interpreted the phrase "in accordance with the laws and regulations" as a screening instrument for illegal investments rather than a limitation on the definition of investment.[191] This is a common addition in many recent investment treaty models wishing to avoid protection of illegal investments.[192]

Finally, the New Model's "investment" definition does not include pre-investment expenditures.[193] Common in public works tenders procedures, these expenditures include, among other things, financing, negotiating, engineering, legal work, environmental studies, and financial advisory.[194] Although Israeli

188. *Id.*

189. Thus, for example, a formal international agreement for the sale of goods can be defined as an investment if the goods are sold in connection with an existing investment. *See, e.g.*, S.D. Myers Inc. v. Canada, 8 ICSID (W. Bank) 3, 60-61 (2000) (finding no reason why a measure that concerned goods under Chapter 3 of NAFTA could not be a measure relating to an investor or an investment under Chapter 11 of NAFTA).

190. *See, e.g.*, Salini Costruttori S.p.A. v. Kingdom of Morocco, 6 ICSID (W. Bank) 398, 410 (2004) (Morocco's claim).

191. *E.g.*, Consortium Groupement L.E.S.I.-DIPENTA v. Algeria, ICSID (W. Bank) Case No. ARB03/08, Award, ¶ 24 (Jan. 10, 2005); *PSEG Global Inc.*, 11 ICSID (W. Bank) at 455. *Contra* Fraport AG Frankfurt Airport Serv. Worldwide v. Philippines, ICSID (W. Bank) Case No. ARB/03/25, Award, 400-41 (Aug. 16, 2007).

192. For example, several U.S. treaties include in the "investment" definition an additional requirement that the treaty protection is limited to investments that have been made "in accordance with the laws and regulations" of the host state.

193. *See* New Model BIT, *supra* note 76, art. 1.

194. In emerging markets that usually involve high levels of pre-investment expenditures these expenditures play a significant role in investment decision and investment process, and have an impact on the competitiveness of the market. *See* Walid Ben Hamida, *The Mihaly v. Sri Lanka Case: Some Thoughts Relating to the Status of Pre-Investment Expenditures, in* INTERNATIONAL INVESTMENT LAW AND ARBITRATION:

investors have increased their participation in public works tenders in foreign markets in recent years,[195] the drafters of the New Model did not find it appropriate to protect these costs as part of the "investment" protection.

A careful look at "investment" definitions in other bilateral and multilateral agreements, along with investment arbitration jurisprudence, supports this conservative view of pre-investment expenditures. Article 25 of the International Centre of Settlement of Investment Disputes ("ICSID") Convention, the legal source for ICSID jurisdiction, does not define "investment."[196] Culminating in *Mihaly International Corp. v. Sri Lanka*[197] and *Zhinvali Development Ltd. v. Republic of Georgia*,[198] several investment arbitration cases recently examined whether pre-investment costs should be included in the investment definition of the ICSID Convention or other BITs.

Although it is hard to identify a clear precedent in those cases, the *Mihaly* and *Zhinvali* approach reimburses investors for their pre-investment expenditures only if there is a final agreement to receive the investment. Thus, the conclusion of an investment agreement retrospectively pushes pre-investment costs under the investment umbrella. Alternatively, pre-investment expenditures could be considered a protected investment if there is an agreement between the investor and the host state to treat these expenditures as such.[199]

As Ben Hamida points out, the *Mihaly* and *Zhinvali* tribunals were careful to limit their holdings to the specific facts before them.[200] Consequently, future arbitral tribunals might reach different conclusions.[201] Thus, it is not surprising that Israel, like other countries, prefers to leave the question of pre-investment

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LEADING CASES FROM THE ICSID, NAFTA, BILATERAL TREATIES AND CUSTOMARY INTERNATIONAL LAW 47, 50-51 (Tod Weiler ed., 2005).

195. Market Israel Tenders and Consulting Opportunities Worldwide, http://dgm.export.gov.il/tenders/SearchResult.do (last visited Feb. 6, 2010).

196. *See* International Centre for Settlement of Investment Disputes [ICSID], *ICSID Convention, Regulations and Rules*, art. 25(1), ICSID/15 (Apr. 2006).

197. Mihaly Int'l Corp. v. Sri Lanka, 6 ICSID (W. Bank) 310 (2004).

198. Zhinvali Dev. Ltd. v. Republic of Georgia, 10 ICSID (W. Bank) 3 (2003).

199. *Mihaly*, 6 ICSID (W. Bank) at 322; *Zhinvali*, 10 ICSID (W. Bank) at 100; Ben Hamida, *supra* note 194, at 74-75.

200. Ben Hamida, *supra* note 194, at 74-75.

201. Indeed, at least on tribunal has reached a different conclusion regarding pre-investment expenditures. Nagel v. Czech Republic, 13 ICSID (W. Bank) 30, 91-92 (2003).

expenditures to ad-hoc procedures rather than to include it within the "investment" definition in the Israeli BIT.

In any case, it seems that when a state explicitly excludes pre-investment expenditures from "investment" protection through a contract provision, arbitration tribunals will follow the language of the contract.[202] An examination of the Israeli government public tenders' language reveals that Israel, in fact, follows this recommendation and opts out pre-investment expenditures when a bidder loses its bid.[203]

2. Who is an "Investor" for the Purposes of the Treaty?

Bilateral investment treaties protect investments made by investors from home states in host territories. Although investment treaties generally cover a broad range of types of investments, we have seen that different BITs take different approaches towards defining "investment" in order to encourage desired foreign investments and protect investments that primarily enhance host state's development. An "investor" definition, on the other hand, tends to be universal, with some common variations.[204] This section will elaborate on several legal problems that demonstrate the complexity of the "investor" element of Israeli and other countries' BITs.

That investment treaties differentiate between natural persons and legal entities is clear, as natural persons have to meet the "nationality" requirement in order to be protected by an investment treaty, whereas legal entities do not. With respect to natural persons, several treaties, including NAFTA,[205] expand the

202. *See* Ben Hamida, *supra* note 194, at 76.

203. *See, e.g.*, MINISTERIAL COMMITTEE FOR PRIVATIZATION MATTERS, THE GOVERNMENT COMPANY AUTHORITY, SALE PROCEDURE FOR THE SALE OF THE SHARES HELD BY THE STATE OF ISRAEL IN THE ISRAEL GOVERNMENT COINS AND MEDALS CORPORATION LTD. PRIVATE COMPANY NUMBER 51-0298573, at 29-30 (2007) (Israel).

204. *See, e.g.*, U.S. 2004 Model BIT, *supra* note 27, at 6-7; Agreement Between the Government of the State of Israel and the Government of the Republic of Uzbekistan for the Promotion and Reciprocal Protection of Investments, Isr.-Uzb., art. 1, July 4, 1994, 1997 U.N.T.S. 107, *available at* http://www.mfa.gov.il/mfa/usercontrols/TreatFile.aspx?SAFA=2&AMANA=1573; Israel-Mongolia BIT, *supra* note 55, art. 1; Ethiopia-Israel BIT, *supra* note 103, art. 1; U.S.-Jordan BIT, *supra* note 170, art. 1.

205. NAFTA, *supra* note 166, art. 201 (treaty's protections apply to both citizens and permanent residents).

"nationality" test to include investors who are permanent residents. Similarly, the New Israeli Model follows the Old Model and includes in the definition of "investor" a "natural person who is a national or permanent resident"[206] of the home state. The New Model also addresses the problem of dual citizenship and excludes investors who are citizens of both home and host states.[207] Nevertheless, several Israeli BITs do protect investors who are also citizens of the host state, allowing these investors to be considered citizens of the home state for the purposes of the treaty.[208] In the future, however, Israel may want to treat dual citizens as citizens of that party's dominant or effective nationality, as does the new U.S. model,[209] instead of automatically accepting the investor's home nationality, which effectively defeats the purpose of the treaty. By applying the dominant or effective nationality, Israeli BITs will follow customary international law standards, which require a case-by-case analysis.[210]

Article 25(2) of the ICSID Convention similarly contains a jurisdictional requirement based on nationality. ICSID jurisdiction, however, is not extended to permanent residents and dual citizens.[211] Thus, while Israeli treaties may meet the jurisdictional requirements of several investment arbitration

206. New Model BIT, *supra* note 76, art. 1; Old Model BIT, *supra* note 59, art. 1, § 3(a) ("[N]atural persons who are nationals or permanent residents of the Contracting Party concerned who are not also nationals of the other Contracting Party . . . .").

207. New Model BIT, *supra* note 76, art. 1 (treaty covers investors "who [are] not also a national of the other Contracting Party").

208. *See, e.g.*, Agreement Between the Government of Romania and the Government of the State of Israel for the Reciprocal Promotion and Protection of Investments, art. 1, § c, Aug. 3, 1998, *available at* http://www.financeisrael.mof.gov.il/FinanceIsrael/Docs/En/InternationalAgreements/POI/Romaniapoi.pdf.

209. U.S. 2004 Model BIT, *supra* note 27, at 4.

210. These standards were originally adopted by the ICJ's Nottebohm tribunal in the context of diplomatic protection in international law. Nottebohm Case (Liech. v. Guat.), 1955 I.C.J. 4, 22-23 (Apr. 6). Although these standards were questioned, U.N. Int'l Law Comm., *Report of the International Law Commission*, 175-76, U.N. Doc. A/57/10 (2002), they may still be applicable in cases of multiple nationality. CATHERINE YANNACA-SMALL, INTERNATIONAL INVESTMENT LAW: UNDERSTANDING CONCEPTS AND TRACKING INNOVATIONS 12 (2008).

211. *ICSID Convention, Regulations and Rules*, *supra* note 196 art. 25(2)(a) ("any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered . . . but does not include any person who on either date also had the nationality of the Contracting State party to the dispute . . . .").

forums consented to the by the parties, they may not meet the jurisdiction requirements of an ICSID forum.

Nevertheless, even though the extension of treaty rights to permanent residents cannot extend ICSID's jurisdiction to such investors, a review of ICSID arbitration decisions shows a potential adoption of the "effective and dominant citizenship" standard in a case of dual citizenship,[212] despite the absence of such standard in the ICSID Convention.[213]

In a global economy investors may possess dual and multiple nationalities through family and business ties. A total exclusion of these investors from the protection of ICSID and investment treaties will reflect inflexibility in an important developing area of international law. A good, practical solution for multi-national investors who want to secure jurisdiction in future investment arbitration disputes is corporate vehicles, which are not subject to the nationality requirement.

Investors often incorporate local legal entities in the host state in order to manage and operate their investment. These entities are usually considered as nationals of the host states according to their respective national laws. In order to allow such investors to pursue investment arbitration procedures, however, investment treaties frequently accord protection to foreign-controlled legal entities and provide a wide range of tests for "foreign control" with respect to the "nationality" of the corporation under consideration.[214]

The New Israeli Model extended section 3(b) of the Old Model definition, suggesting a new test for a corporate investor that covers a corporation "that was incorporated or constituted under the law"[215] of the home state, or a corporation "that is controlled, directly or indirectly, by persons who are nationals or permanent residents" of the home state.[216] The corporation must

212. *See, e.g.*, Champion Trading Co. v. Egypt, ICSID (W. Bank) Case No. ARB/02/9, Decision on Jurisdiction, 288 (Oct. 21, 2003) (suggesting that it may be unreasonable to consider a party a dual national where, although legally a citizen of his forefathers state, he has no ties with that country whatsoever).

213. *See ICSID Convention, Regulations and Rules*, *supra* note 196, arts. 25-27.

214. For a detailed review of investment treaties' practice on this issue, see U.N. Conference on Trade and Development (UNCTAD), *Investor-State Dispute Settlement and Impact on Investment Rulemaking*, 12-15, UNCTAD/ITE/IIA/2007/3 (Sept. 2007) (prepared by Roberto Echandi) [hereinafter UNCTAD (2007)].

215. New Model BIT, *supra* note 76 art. 1.

216. *Id.* art. 1, § 5(b)(2).

also fulfill one of the following conditions: (i) its registered office, center of management, or practical management is located in either home or host state; (ii) a substantial part of its economic activity is located in the territory of either home or host state; or (iii) it was incorporated or constituted under the law of the host state.[217] This definition provides protection for foreign investors who hold their investment through a local legal entity, but at the same time ensures that the corporate vehicle under consideration has significant links to one of the contracting states. The definition of corporate nationality will also be important for an ICSID procedure since the jurisdictional requirements of the ICSID Convention must be met in addition to the BIT jurisdictional requirements. The jurisdictional requirements of the ICSID Convention include (i) an agreement between the parties to the dispute to treat a legal entity of the host country as foreign, and (ii) an entity that is effectively controlled by foreigners.[218] Although the scope of ICSID tribunals' review of the jurisdictional test for legal entities is unclear, recent cases, such as the *Aucoven* case, confirm that any definition of corporate nationality in an investment treaty based on a "reasonable criterion" will be accepted, as long as it is consistent with the purpose of the ICSID Convention.[219] Since the reference to "control" in the New Israeli Model contains an open-textured language, BITs jurisdiction can provide some substance to the "control" test, which can be used for both Israeli treaties' interpretation and ICSID jurisdiction analysis.[220]

Home state investors also frequently use a subsidiary in a third country as a holding company to effectuate their investment in the host state.[221] This allows investors to take advantage of the legislation of a third country, usually for tax purposes, and simultaneously invest in the host state, with which their home

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217. *Id.* art. 1, § 5(b)(2)(i)-(iii).

218. *ICSID Convention, Regulations and Rules*, *supra* note 196, art. 25(2)(b).

219. Autopista Concesionada de Venezuela, C.A. v. Venezuela, 6 ICSID (W. Bank) 419, 501-02 (2001). Consequently, the Aucoven tribunal found direct shareholding as a mean to participate in the company's decision making and a reasonable test for control. *Id.* at 508-13.

220. *See* UNCTAD (2007), *supra* note 214, at 12-15 (reviewing recent arbitration cases which deal with the "foreign control test" for the purposes of investment treaties and ICSID jurisdiction).

221. *Cf.* Waste Management, Inc. v. Mexico, 43 I.L.M. 967, 983 (2004) (discussing the definition of investor in the North American Free Trade Agreement (NAFTA)).

country has signed an investment treaty. BITs often provide protection to such investors with respect to an investment in the host state, and the New Israeli Model, in fact, includes "indirectly" controlled entities in its definition of "investor."[222] Foreign investors occasionally use this structure to take advantage of a BIT between the home state and a third country when there is no BIT between the home and host state.[223]

Several recent investor-state arbitration cases have raised the question of the ability of shareholders in general, and minority owners in particular, to bring a direct claim against the host state when the company's rights are deprived.[224] The investment law jurisprudence is consistent—shareholders may bring a direct claim against the host state for the loss of their proportionate shareholder value, as long as the "investment" definition in the BIT is broad enough to express the parties' consent to protect shareholder value.[225] Since most of BITs do not differentiate between majority and minority shareholding, investment arbitration tribunals have consistently refused to accept the argument that only majority investors can bring an investment claim due to their influence on the corporation under consideration.[226]

The New Israeli Model, similar to several leading investment treaty models, offers a broad "investment" definition, which includes "rights derived from stocks, shares, bonds, debentures and other kinds of interests in companies."[227] This definition follows the current jurisprudence, which accepts shareholders'

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222. Article 1, Section 5(b)(2) of the New Model, which defines legal entity investor for the purpose of the scope of the treaty, includes entities "that [are] controlled, directly or indirectly, by persons who are nationals or permanent residents of the Home Contracting Party." New Model BIT, *supra* note 76 art. 1.

223. *See* Jose E. Alvarez, *Empire: Contemporary Foreign Investment Law: An "Empire of Law" or the "Law of Empire"?*, 60 Ala. L. Rev. 943, 958 (2009).

224. *See, e.g.*, CMS Gas Transmission Co. v. Argentina, 7 ICSID (W. Bank) 492, 508-09 (2003); GAMI Inv., Inc. v. Mexico, UNCITRAL (Nov. 12, 2004) (Final Award), reprinted in 44 I.L.M. 545, 550-553 (2005); Enron Corp. v. Argentina, 11 ICSID (W. Bank) 268, 283 (2007).

225. *See, e.g.*, Stanimir A. Alexandrov, *The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of the ICSID Tribunals: Shareholders as "Investors" and Jurisdiction Ratione Temporis*, 4 LAW PRAC. INT'L CTS. & TRIBUNALS 19, 40-45 (2005).

226. *See, e.g.*, Lanco Int'l, Inc. v. Argentina, ICSID Case No. ARB/97/6, Preliminary Decision (Dec. 8, 1998), 40 I.L.M. 457, 461, 463 (2001); *CMS Gas*, 7 ICSID (W. Bank) at 508-09; *GAMI*, 44 I.L.M. at 550-553; *Enron Corp*, 11 ICSID (W. Bank) at 283.

227. New Model BIT, *supra* note 76, art. 1.

rights under BITs and ICSID's jurisdiction, and does not differentiate between majority and minority shareholding for jurisdictional purposes. Most investment treaties,[228] including the New Israel Model, do not require that the shares be held directly and, in fact, can be held indirectly through intermediate vehicles. The language of "investor" definition in the Israeli model,[229] following recent ICSID decisions,[230] supports this approach.

However, since the goal of the treaty is to protect economic activities with close and transparent ties to the contacting states even in cases of indirect ownership or control, Section 5(b)(2) of Article 1 of the New Model states several conditions, at least one of which should be met in order to confirm that the investment is connected to the contracting parties.[231] It should be noted, though, that since indirect ownership or control[232] could be achieved through other intermediate companies or persons, including those of third countries, the treaty's coverage opens the door to protection of investors using intermediate hostile entities from a third country. Thus, in addition to permitting a thorough judicial review by investment arbitration tribunals, the conditions set by the "investor" definition discussed above are also designed to protect the security interests of the parties according to the spirit of the treaty.

The definition of a corporate investor in the New Israeli Model does not address all possible scenarios. It does not differentiate between a private and governmental entity,[233] nor does it differentiate between for-profit and not-for-profit entities. This lacuna may expose the Israeli government to unnecessary

228. *See, e.g.*, NAFTA, *supra* note 166, art. 1117(1).

229. Article 1, Section 5(b)(2) of the New Israeli Model applies the treaty to a corporation "that is controlled, directly or indirectly, by persons who are nationals or permanent residents." New Model BIT, *supra* note 76, art. 1.

230. *See, e.g.*, Gas Natural SDG S.A. v. Argentina, ICSID (W. Bank) Case No. ARB/03/10, Decision of the Tribunal on Preliminary Questions on Jurisdiction, 21-22 (2005), *available at* http://www.asil.org/pdfs/GasNat.v.Argentina.pdf; *CMS Gas*, 7 ICSID (W. Bank) at 508-09.

231. New Model BIT, *supra* note 76, art. 1.

232. Although not specifically defined in the treaty, control in this context usually means ownership of over 50 percent of the voting stock of a company. Many other times, different arrangements will satisfy the requirement.

233. Other investment treaties do make these distinctions. For instance, the U.S. Model BIT defines "enterprise" as a legal entity "whether or not for profit, and whether privately or governmentally owned or controlled . . . ." U.S. 2004 Model BIT, *supra* note 27, art 2.

litigation with political groups or foreign government entities, especially in the context of intra-governmental security transactions. Investment arbitration tribunals tend to strictly interpret the legal form requirement of a BIT and the jurisdictional provision of the ICSID Convention.[234] Therefore, a reassessment of the Israeli definition may be appropriate in light of these circumstances. Finally, the investment treaty's definitions are inherently connected to other substantive provisions of the treaty. A comparison between the U.S. 2004 Model BIT and the New Israeli Model reveals that only the former includes an investor who "attempts to make" an investment and not only one who "is making, or has made an investment in the territory."[235] This significant distinction is a result of the different approaches to investment pre-establishment in the treaties.[236] The Israeli model applies investor protection standards to post-establishment only, while in comparison, the U.S. 2004 Model BIT, which promotes liberalization of foreign markets, applies investment treaties also to the pre-establishment phase.[237] The U.S. definition of "investor" is thus adjusted according to the national treatment and most-favored-nation provisions of the treaty.

To summarize, "investor" and "investment" definitions in Israeli investment treaties, which provide the scope of the treaty's coverage, encompass a wide range of economic activities and investment structures. The definitions are also capable of being adapted to new and complex investment instruments and corporate structures as foreign investors become more sophisticated and take advantage of the global economy. This article, however, pointed out several lacunas and implications of Israeli investment treaties, which the Israeli government may decide to address in future treaties.

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234. Article 25(2)(b) of the ICSID Convention states the legal personality requirement to be met for jurisdiction purposes. *ICSID Convention, Regulations and Rules*, *supra* note 196, art. 25(2)(b). *See, e.g.*, Impregilo S.p.A. v. Pakistan, ICSID (W. Bank) Case No. ARB/03/3, Decision on Jurisdiction, 37 (2005).

235. U.S. 2004 Model BIT, *supra* note 27, at 4. Note that in addition to defining "investor of a Party," the treaty also defines an "investor of a non-Party" for the purposes of the treaty. The consequences of an investment by an investor of a non-Party will not be discussed in this paper in detail due to its minor importance to the discussion.

236. *See infra* Part VI.C.1.

237. The application of the investors protection standards is not absolute and is subject to several qualifications and exceptions based on investment treaties' language and investment arbitration jurisprudence. *See infra* Part VI.C.1.

B. Promotion and Protection of Investment – Absolute Standards (Fair and Equitable Treatment; Full Protection and Security)

All Israeli BITs include a preamble that serves as an opening remark for the treaty.[238] Article 2 of the New Model states its goals and each of the contracting parties' obligations: to encourage and protect foreign direct investment in its territory.[239] Whereas the obligation to protect foreign investment is a legal one with a minimum standard of treatment that is frequently discussed and interpreted by the courts, the preamble encouraging foreign investment is merely a declarative statement, with no clear legal obligation or standard. In fact, the obligation to protect foreign investment is perceived as a way to encourage foreign investors to invest in host states.[240]

Each party's first obligation in the New Model is to "encourage and create favorable conditions for investments by investors of the other Contracting Party and . . . shall admit such investments."[241] This obligation is not absolute and is "subject to its laws and regulations and subject to its right to exercise the powers conferred by its laws and regulations."[242] This reservation reflects the government's ability not only to create favorable conditions for foreign investment, but also to foster sustainable development by strengthening the local economy according to local laws and international commitments. Similar language has served in several arbitration cases as a general guideline in a treaty interpretation process seeking to balance investors' protection with long-term goals of the host state, which may add another substantive layer to the declaratory aspect of the treaty's preamble.[243]

According to the second obligation included in the introductory provision of the New Model, each contracting party commits to "fair and equitable treatment" and "full protection and security" of foreign investors, and each contracting party shall not "impair by unreasonable measures" any aspect of the

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238. *Cf.* MCLACHLAN, *supra* note 4, at 28-29.

239. New Model BIT, *supra* note 76, art. 2.

240. MCLACHLAN, *supra* note 4, at 28-29.

241. New Model BIT, *supra* note 76, art. 2.

242. *Id.* The previous Israeli model BIT used the following language: "subject to its right to exercise the powers conferred by its laws." Old Model BIT, *supra* note 59, art. 2, § 1.

243. *See, e.g.*, *Saluka Investments*, *supra* note 25, at 42.

investment.[244] Fair and equitable treatment and full protection and security standards are part of substantive investors' rights that are included in the vast majority of investment treaties, and virtually all BITs.[245] Unlike national treatment and MFN standards, these standards are absolute and provide a certain level of protection regardless of the level of protection given to the host state's own nationals or nationals of other states.[246]

The fair and equitable standard is subject to an ongoing debate about whether it is equivalent to the international minimum standard of treatment under customary international law, or if it is an independent standard that can be interpreted separately.[247] Although this standard is interpreted on a case-by-case basis, it is generally perceived as a rule of law applicable to all branches of domestic government, including the national legislature, domestic administration, and domestic courts.[248] Consequently, the fair and equitable standard can include, among other obligations, the protection of an investor's legitimate expectations, procedural due process and denial of justice, predictability of the legal system, protection against discrimination and arbitrariness, and commitment to transparency, reasonableness and proportionality.[249] Although most of these principles are well integrated into the Israeli legal system, the potential impact of the fair and equitable treatment standard on the domestic government can be significant and should not be ignored.[250]

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244. New Model BIT, *supra* note 76, art. 2.

245. MCLACHLAN, supra note 4, at 30.

246. Stephan W. Schill, *Tearing Down the Great Wall: The New Generation Investment Treaties of the People's Republic of China*, 15 CARDOZO J. INT'L & COMP. L. 73, 103 (2007) [hereinafter *Tearing Down the Great Wall*].

247. For instance, the FTC analyzed Article 1105 of NAFTA, which provides investors treatment according to minimum standard in international law, and concluded that this provision refers to customary international law, which includes fair and equitable treatment and full protection and security. FREE TRADE COMM'N, NOTES OF INTERPRETATION OF CERTAIN CHAPTER 11 PROVISIONS (2001).

248. Stephan W. Schill, *Fair and Equitable Treatment Under Investment Treaties as an Embodiment of the Rule of Law* 23 (Inst. for Int'l Law and Justice, Working Paper No. 2006/6, 2006), *available at* http://www.iilj.org/publications/documents/2006-6-GAL-Schill-web.pdf (last visited Nov. 10, 2009).

249. *Id.* at 11-23.

250. A similar argument was raised by Stephan Schill in the context of the Chinese legal system. *Tearing Down the Great Wall*, *supra* note 246, at 103-06.

The full protection and security obligation, which is tied to the fair and equitable standard, provides the guarantee of full protection by granting police protection against physical interferences by private actors.[251] Although cases involving the full protection and security obligation tend to be less common in recent times, early investment arbitration claims raised this obligation in the context of destruction of real estate by local armed forces.[252] The full protection and security standard, for example, may raise the level of protection required from Israeli authorities to secure foreign investments in Israel against local terrorism.[253]

To conclude, investor-state arbitration jurisprudence has developed the meaning and place of "fair and equitable treatment" and "full protection and security" standards in protection of foreign investors.[254] Israel, which adopted this exact evolutionary standard in both its Old and New Models without providing its content, will have to adjust texts of future treaties to the existing and developing concepts of these obligations in international investment law.

C. The Contingent Principles: Most Favored Nation and National Treatment

The national treatment and most favored nation ("MFN") principles, usually described as "contingent standards"[255], of any BIT, have become an integral part of the investment protection treatment in customary international law and investment treaties practice.[256] Although familiar to us from international trade law, these rights have been subject to increasing litigation and to an independent interpretation process in international investment arbitration.[257] Since the bilateral process of investment treaties does not usually provide informative guidance on the public record with regard to the intention of the parties, arbitral tribunals find it difficult to unveil the content behind the "open-textured

251. MCLACHLAN, *supra* note 4, at 247.
252. *See, e.g.*, Am. Mfg. & Trading Inc. v. Zaire, 5 ICSID (W. Bank) 11, 11 (1997).
253. *See* MCLACHLAN, *supra* note 4, at 247-248.
254. *See, e.g.*, Mondev Int'l, Ltd. v. U.S., 6 ICSID (W. Bank) 181, 215, 222 (2002); ADF Group, Inc. v. U.S., 6 ICSID (W. Bank) 449, 529-30 (2004).
255. MCLACHLAN, *supra* note 4, at 210-11.
256. *See id.* at 254.
257. *See id.* at 201.

language" of the treaties.[258] It should be noted that although this article carefully analyzes the bilateral process based on governmental documents and interviews with government officials, these sources are not part of the public record.

According to the national treatment principle, as described in Article 3, Section 1 of the New Israeli Model, parties to the treaty cannot "subject investments or returns of investments . . . to treatment *less favorable than* that which it accords to investments or returns of investments of *its own investors*."[259] The MFN principle similarly requires that the parties cannot subject investments or returns of investments "to treatment *less favorable than* that which it accords to investment or returns of investment of an investor of *any third state*."[260] The national treatment and MFN standards together provide prospective investors with a level playing field in the international investments marketplace.[261] This section will explore these important standards in Israeli treaties in-depth from a comparative perspective.

1. Pre-Establishment Admission and National Regulation of FDI

Even though different model BITs share similar standards regarding the national treatment protection, a major policy difference exists between states that limit the protection to post-establishment operation and states that extend the protection to pre-establishment as well.[262] Since one of the goals of investment treaties is to facilitate access to foreign investment,[263] the question whether an investment treaty extends the right of establishment is crucial. A treaty's language will explicitly state its policy on the issue.[264] A close review of current trends in investment treaties shows three types of investment treaties: American (followed by other Western states), European, and South-South agreements

258. *Id.* at 202.

259. New Model BIT, supra note 76, art. 3 (emphasis added).

260. *Id.* (emphasis added).

261. MCLACHLAN, *supra* note 4, at 210-11 (explaining that these standards "are usually described as 'contingent standards' in that the quality of treatment which they prescribe in determined by reference to that accorded to others in the same position.")

262. *Id.* at 211.

263. Most BITs include a provision that specifies the promotion of foreign investment in the host state as one of the goals of the treaty. For example, the New Israeli Model asks the parties to "encourage and create favorable conditions for investments by investors. . . ." New Model BIT, *supra* note 76, art. 3.

264. *See* MCLACHLAN *supra* note 4, at 211.

between two developing countries.[265] The status of pre-establishment of FDI is one of the key differentiators between the U.S. and the European models.[266]

Various investment treaty models show mixed attitudes towards pre-establishment foreign investments.[267] While the U.S. model refers to "the *establishment, acquisition, expansion*, management, conduct, operation, and sale or other disposition of investments in its territory,"[268] with regards to national treatment and MFN standards, the U.K. model does not extend this protection to the pre-entry phase.[269] Looking at multilateral investment agreements signed by states with traditional conflicting interests and developing investment jurisprudence, NAFTA extends national treatment and MFN protections to the pre-establishment phase.[270]

The Energy Charter Treaty ("ECT") extends the protection of the national treatment standard to the making of an investment only by negotiation of an unconcluded subsequent treaty. Meanwhile, all exceptions should be notified to the principal of the ECT Secretariat.[271]

The New Israeli Model extends the application of the contingent standards to "management, maintenance, use, enjoyment or disposal" of the investment,[272] which suggests that the Israeli model follows the U.K. model's approach in protecting investors only in the post-establishment phase. The Israeli government's policy can be explained by its desire to preserve its

265. U.N. Conference on Trade and Development [UNCTAD], UNCTAD Series on International Investment Policies for Development, *South-South Cooperation in International Investment Arrangements*, U.N. Doc. UNCTAD/ITE/IIT/2005/3 (2005) [hereinafter South-South Cooperation].

266. MCLACHLAN *supra* note 4, at 211.

267. *See id.* at 211-12.

268. U.S. 2004 Model BIT, *supra* note 27, at 6 (emphasis added).

269. Article 2(1) of the U.K. Model BIT states that the obligation upon the host state to admit capital is made "subject to its right to exercise powers conferred by its laws", which practically prevents any expansion of the national treatment standard to the pre-establishment phase. *See* RUDOLF DOLZER AND CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 376 (2008) [hereinafter U.K. Model BIT].

270. NAFTA, *supra* note 166, arts. 1102-03 (granting rights to foreign investors in the "establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments"). Article 1104 also provides that the investor is entitled to "the better of the treatment required by Articles 1102 and 1103." *Id.* art. 1104.

271. Energy Charter Treaty art. 10 § 8, Dec. 17, 1994, 2080 U.N.T.S. 95.

272. New Model BIT, supra note 76, art. 3.

ability to determine the conditions under which it will admit foreign investment, while keeping a preferred treatment to local investors. From a historical perspective, it can be argued that because Israel signed its first investment treaty with Western European country,[273] and Israel's legal system is based on the English common law,[274] the European model has had a significant influence on the development of the Israeli model.

The question of the applicability of certain standards to the pre-establishment phase is part of a broader discussion about the role of investment liberalization in bilateral investment treaties.[275] The national treatment and MFN principles enhance free admission of FDI but at the same time they directly limit the power of national legislation, which affects states' ability to regulate local industries.[276] States relinquish some flexibility to limit the exposure of certain local industries to global competition in order to develop and protect infant industries or national champions based on local economic needs and political pressure.[277] The tension between the competitive global market for foreign investments and local, national development concerns shapes the FDI legal framework.

A broad legislation in Israel, through general laws and industry-specific regulations, imposes significant discriminating limitations on the way foreign investors can invest or operate in, among other fields, the real estate market, defense companies, state-owned companies, companies that provide "necessary" services, or services with strong security or national aspects.[278] Proposed regulations concerning security and defense companies in Israel are subject to a complex process with a thorough review mechanism programmed to balance security interests with the needs of a market economy.[279] Nevertheless, certain desirable

273. Treaty Between the State of Israel and the Federal Republic of Germany Concerning the Encouragement and Reciprocal Protection of Investments, June 24, 1976, *available at* http://www.mfa.gov.il/mfa/usercontrols/TreatFile.aspx?SAFA=2&AMANA=774.

274. Guy Mundlak, *The Israeli System of Labor Law: Sources and Form*, 30 Comp. Lab. L. & Pol'y J. 159, 159 (2009).

275. *See* Salacuse & Sullivan, *supra* note 97, at 76.

276. *See id.* at 70-71, 77.

277. *See id.* at 77.

278. U.S. Department of State 2009 Investment Climate Statement – Israel, http://www.state.gov/e/eeb/rls/othr/ics/2009/117445.htm.

279. *Id.*

investments may be blocked by a protective legislation driven by a pro-security government. The same argument can be made with respect to other discriminatory measures. The lack of transparent admission policy in Israel may therefore hurt its credibility and potentially reduce foreign investment inflows in the future.[280] An investment treaty can serve as the right instrument to solve this problem by slowly shifting from an investment-control-model to a negative-list-model, which provides for a limited list of exceptions.[281] Nevertheless, Israel may continue to reduce the number of pro-admission legal instruments. Its new OECD membership will limit its ability to do so due to its commitment to the various OECD pro-admission instruments.

Once a foreign investment is established in the host state, either through a free admission policy or as a result of lax screening policies, it enjoys the protection of the national treatment and MFN obligations of the treaty. Correspondingly, this article will now discuss each one of these standards to evaluate the level of protection they accord, especially in the Israeli context.

2. National Treatment

The national treatment obligation was discussed in several leading NAFTA investment cases and BIT procedures with inconsistent results.[282] Nevertheless, the majority of the jurisprudence regarding the NAFTA "no less favorable" national treatment standard[283] concludes that foreign investors should get a treatment equivalent to the best treatment accorded to domestic investors without a need to show disproportionate disadvantage to

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280. *See* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 145 (1999) (observing that the international investment community "values stability, predictability, transparency and the ability to transfer and protect its private property from arbitrary or criminal confiscation").

281. *See* Org. for Econ. Co-Operation and Dev. [OECD], International Investment Perspectives 176 (2006), *available at* http://browse.oecdbookshop.org/oecd/pdfs/browseit/2006061E.PDF (noting that the use of a negative list approach facilitates broader coverage, progressiveness and transparency).

282. *See generally* Jürgen Kurtz, *The Use And Abuse Of WTO Law In Investor--State Arbitration: Competition And Its Discontents*, 20 EUR. J. OF INT'L L. 749, 759-69 (2009) (exploring the history of substantive analysis by an investor–state arbitral tribunal of the national treatment obligation). *See also Response to 'The Use and Abuse of WTO Law in Investor-State Arbitration'*, Robert Howse and Efraim Chalamish, European Journal of International Law, Nov 01, 2009; 20: 1087-1094.

283. NAFTA, *supra* note 166, art. 1102.

the foreign investor.[284] The Israeli New Model, which uses the same "no less favorable" expression,[285] should be interpreted in the same manner.

In order to evaluate the host country's treatment of a foreign investor, investment arbitral tribunals compare the treatment of the prospecting foreign investor and the most directly comparable local investor or investors in the same business or economic sector,[286] even when only one investor is in the same business sector.[287] If indeed a different treatment exists, the tribunal examines whether the different treatment has "a reasonable nexus to rational government policies that (1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives" of the treaty.[288] "At least one case has found an export ban with a protectionist motive did not impact the comparison analysis."[289]

The contingent standards in the U.S. 2004 Model BIT, following other typical models, require that equal treatment will be accorded to foreign investors "*in like circumstances*."[290] Borrowed from international trade law, this expression was interpreted by investment arbitral tribunals to include the test mentioned above.[291] The *Methanex Corp. v. United States* tribunal, however, which discussed the ban imposed in California on the use of Methanol in the reformulated gasoline market, did not import the term "any like, directly competitive or substitutable goods" from the General Agreement on Tariff and Trade ("GATT") into

284. *See, e.g.*, Pope & Talbot Inc. v. Canada, 7 ICSID (W. Bank) 43, 110, 118 (2001) (assessing the discriminatory softwood lumber regime and finding a breach of Article 1102 of NAFTA, the national treatment provision).

285. New Model BIT, *supra* note 76, art. 3.

286. *But see* Occidental Exploration and Prod. Co. v. Ecuador, LCIA Case No. UN 3467 (July 1, 2004) (Final Award), reprinted in 12 ICSID (W. Bank) 54, 92 (2005) (rejecting the comparison with the applicable sector exclusively).

287. *See* Feldman v. Mexico, 7 ICSID (W. Bank) 318, 388-97 (2005).

288. *Pope & Talbot*, 7 ICSID (W. Bank) at 120.

289. S.D. Myers Inc. v. Canada, ¶¶ 254-55 (NAFTA/UNCITRAL Arb. Trib. 2000) (Partial Award) *available at* http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/myersvcanadapartialaward_final_13-11-00.pdf.

290. U.S. 2004 Model BIT, *supra* note 27, at 6-7 (emphasis added).

291. *See e.g.*, United Parcel Service of America, Inc. v. Canada, ¶¶ 87-120, Award of May 24, 2007 *available at* http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/MeritsAward24May2007.pdf (analyzing the different features of the Canadian postal services to be compared with UPS' services in Canada).

the meaning of "in like circumstances" in investment treaties.[292] The tribunal cited the limited scope of the text and the fact that NAFTA refers specifically to the GATT when applicable as support for its decision.[293]

The Israeli New Model does not include the expression "in like circumstances" in the contingent standards article but refers generally to "treatment less favorable."[294] It is unclear whether it is a lacuna or whether the draft treaty, in fact, does not intend to follow the majority view in investment arbitration jurisprudence and investment treaties drafting practice. In order to avoid ambiguity in the future, future Israeli negotiators may want to consider including a more detailed version of the text of the test to be applied in the national treatment obligation.

The implication of the national treatment principle in the Israeli context is challenging in light of the transition from a government-based economy to a market-based economy. For several decades Israel adopted discriminatory legislation measures that protected local investors by eliminating any competition with foreign players. The new market-based economy, which begun in the 1980s and gained power during the 1990s, forced the Israeli government to instate a new competitive legislation that treated foreign investors as it treats local ones.[295] In fact, foreign investors frequently receive a better treatment in Israel than Israeli nationals as part of the governmental scheme to grant them incentives and boost foreign investment into the country.[296] This new reality questions the importance of the national treatment obligation, particularly since formal discriminatory practices in courts and other administrative procedures are still rare. Nevertheless, implementing this obligation will abolish existing practices with respect to state-owned corporations and prevent adoption of new privileges for local investors while discriminating

292. Methanex Corp. v. United States, 44 I.L.M. 1345, 1449 (2005).

293. *Id.*

294. New Model BIT, *supra* note 76, art. 3.

295. *See* ORG. FOR ECON. CO-OPERATION AND DEV., OECD INVESTMENT POLICY REVIEWS: ISRAEL 7 (2002).

296. *E.g.*, State of Israel Ministry of Industry, Trade, & Labor, Investment Incentives in the Law for the Encouragement of Capital Investment, http://www.investinisrael.gov.il/NR/exeres/08348DA2-83D3-47B1-B043-ED418D9AA846.htm (last visited Mar. 13, 2010) (Foreign investors enjoy greater tax benefits over their domestic counterparts).

against foreign investors. Consequently, foreign investors will be able to enjoy the privileges granted to them and at the same time pick from various local regulations that are accessible to them as a result of implementing the national treatment standard.

Israel's integration into the OECD, first as a non-OECD member and most recently as a new member, was the most significant step towards full participation in the global economy as an open and competitive market in recent years. Israel took an important step towards joining the OECD community when it signed the OECD Declaration on International Investment and Multinational Enterprises, which calls for no less favorable treatment of foreign investors than domestic enterprises.[297] Israel joined the declaration following a careful OECD investment policy review, one of the most comprehensive reviews of Israel investment policy ever made.[298] Being associated with the declaration has the likelihood of reinforcing the Israeli government's efforts to pursue investment-friendly economic reforms.

The declaration also promotes voluntary standards of business conduct through the OECD Guidelines for Multinational Enterprises.[299] Adherence to the declaration will enable Israel to share experiences on business conduct with OECD members and other non-OECD signatories. According to the declaration, Israel has the obligation to notify its exceptions to, and other measures taken under, the national treatment obligation for transparency reasons.[300] Israel's traditional investment policy has blocked several sectors for foreign investment or imposed significant barriers on potential foreign investors and, indeed, these exceptions were communicated to the OECD.[301]

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297. Org. for Econ. Co-operation and Dev. [OECD], *The OECD Declaration and Decisions on International Investment and Multinational Enterprises: Basis Texts*, at 6, OECD Doc. DAFFE/IME(2000)20 (Nov. 9, 2000), *available at* http://www.olis.oecd.org/olis/2000doc.nsf/4f7adc214b91a685c12569fa005d0ee7/c125692700623b74c1256991003b5147/$FILE/00085743.pdf [hereinafter *OECD Declaration and Decisions*].

298. OECD INVESTMENT POLICY REVIEWS: ISRAEL, *supra* note 295.

299. *OECD Declaration and Decisions*, *supra* note 297, at 5; Org. for Econ. Co-operation and Dev. [OECD], *OECD Guidelines for Multinational Enterprises* (2008), *available at* http://www.oecd.org/dataoecd/56/36/1922428.pdf.

300. *OECD Declaration and Decisions*, *supra* note 297, at 30.

301. ORG. FOR ECON. CO-OPERATION AND DEV., NATIONAL TREATMENT FOR FOREIGN-CONTROLLED ENTERPRISES: LIST OF MEASURES REPORTED FOR

As a result of the Israeli government's efforts to pursue investment-friendly economic reforms, as well as international pressure led by international organizations such as the International Monetary Fund and the OECD, many of these policies are currently under review or have already been subject to a substantial reform.[302] For instance, Ehud Olmert, then Minister of Industry, Trade and Labor, established on May 2, 2004, an administrative committee known as the Gadish committee after its head, Yaakov Gadish. The committee's goal was to explore the feasibility of several reforms in the Israel Lands Administration ("ILA"). One of the ILA's functions to be reviewed was its predominant role in land purchase approval process. On June 19, 2005, the Israeli government approved the recommendations of the Gadish Committee.[303]

3. Most Favored Nation (MFN)

Like national treatment, the MFN treatment has been subject to an extensive review by international tribunals and the International Law Commission.[304] This standard affords foreign investors in a host state the same treatment as required under specific BIT provisions between the host state and third parties.[305]

Like most investment treaty models, the Israeli model combines the MFN standard with the national treatment standard into one provision using similar language.[306] Hence, the previous discussion regarding the interpretation of terms such as "less favorable than" or "in like circumstances" is also applicable in the context of the MFN obligation.

TRANSPARENCY 45-47 (2009), *available at* http://www.oecd.org/dataoecd/57/46/38273182.pdf.

302. *See* OECD INVESTMENT POLICY REVIEWS: ISRAEL, *supra* note 295, at 13.

303. Press Release, Adalah The Legal Ctr. for Arab Minority Rights in Israel, Adalah to Israeli Government: Proposed Exchange of Land Between the State and JNF will Exacerbate Discrimination against Arab Citizens of Israel and Violate their Basic Rights (June 28, 2005), *available at* http://www.adalah.org/eng/pressreleases/pr.php?file=05_06_28-1.

304. *See, e.g.*, *Summary Records of the 30th Session, Draft Articles on the Most-Favoured-Nation Clauses*, [1978] 1 Y.B. Int'l L. Comm'n 40.

305. *See, e.g.*, MTD Equity Sdn Bhd v. Chile, 12 ICSID (W. Bank) 3, 20-21 (2007) (finding that provisions of Croatia-Chile and Denmark-Chile BITs were applicable to the BIT between MTD, a Malaysian investor, and Chile by operation of the MFN clause in that latter BIT).

306. New Model BIT, *supra* note 76, art. 3.

A significant part of the MFN jurisprudence, however, is tied to the substantive discussion about the scope of the MFN principle. Unlike the national treatment principle, MFN requires a careful review of treaties between third parties, including certain provisions that have been negotiated by these parties. Therefore, the applicability of these provisions to other parties through the MFN clause calls for diligent consideration.[307] Moreover, it is not clear whether arbitral tribunals can apply the MFN clause to the procedural rights of the BIT, or more specifically, to dispute settlement provisions. This is especially unclear due to their bilateral nature, inability to compare treaties and evaluate preferential treatment with respect to legal procedures, and the potential chaos that could be created by applying multiple dispute settlement provisions of several investment treaties in one setting. Yet, since the dispute settlement mechanism makes the BIT's substantive rights enforceable, the correlation between the substantive and procedural rights builds the case for application of the MFN principle to procedural rights.

A careful review of investment arbitration jurisprudence reveals conflicting conclusions on the question of the application of the MFN standard to procedural rights. The leading case is *Maffezini v. Spain*,[308] which was based on the Argentina-Spain BIT.[309] There the tribunal applied the MFN clause to the dispute settlement provisions of the Chile-Spain BIT,[310] whihc did not require recourse to local courts before bringing an ICSID claim. This resulted in a shorter waiting period before applying international investment arbitration.[311] Although several legal scholars heavily criticized this decision,[312] it has been followed by other arbitration cases, such as *Siemens v. Argentina*,[313] *Tecmed v. Mexico*,[314] and *Suez v. Argentina*.[315] The leading argument behind

307. *See* MCLACHLAN, *supra* note 4, at 254.

308. Maffezini v. Spain, 5 ICSID (W. Bank) 387 (2002).

309. Agreement on the Reciprocal Promotion and Protection of Investments, Spain-Arg., Oct. 3, 1991, 1699 U.N.T.S. 202.

310. Agreement on the Reciprocal Protection and Promotion of Investments, Spain-Chile, Oct. 2, 1991, 1774 U.N.T.S. 15.

311. *Maffezini*, 5 ICSID (W. Bank) at 404-11.

312. Stephan W. Schill, *Multilateral Investment Treaties Through Most-Favored-Nation Clauses*, 27 Berkley J. Int'l L. 496, 537 (2009).

313. Siemens AG v. Argentine Republic, 12 ICSID (W. Bank) 171, 207-08 (2007).

314. Tecnicas Medioambientales Tecmed, S.A. v. United Mexican States, 10 ICSID (W. Bank) 130, 153 (2003).

these decisions was that the procedural provisions in investment treaties are inherently connected to the substantive provisions and have an impact on the use of these rights.

Several investment arbitration decisions and draft treaties, however, have disagreed with that approach. For instance, the Dominican Republic-Central America Free Trade Agreement (or CAFTA) explicitly excludes dispute settlement provisions from being covered by the MFN provision.[316] The *Salini v. Jordan*[317] and *Plama v. Bulgaria*[318] decisions have also rejected the *Maffezini* tribunal's rationale. The *Plama* tribunal concluded that any application of the MFN provision to dispute settlement provisions can undermine the harmonization process of dispute settlement provisions and that public policy exceptions do not actually support the rationale behind the rule as interpreted by the *Maffezini* tribunal. As a result, it concluded, the MFN provision should not apply to dispute settlement provisions unless the parties have explicitly agreed to do so in advance.[319]

The Old and New Israeli Models ignore the question and do not refer specifically to procedural provisions in the context of the MFN standard.[320] Historical research does not reveal any public records or judicial decisions that interpret the Israeli MFN provision. Since new generation Israeli investment treaties provide a broader range of substantive and procedural rights than the older generation, one can claim that the parties to an old treaty can use the MFN provision to apply provisions of new treaties with broader protections. Future investment treaties should reflect the Israeli government's view on this topic, although such a view has

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315. Suez, Sociedad General de Aguas de Barcelona S.A. and Interagua Servicios Integrales de Agua S.A. v. Argentine Republic, ICSID (W. Bank) Case No. ARB/03/17, Decision on Jurisdiction, ¶¶ 52-66 (May 16, 2006).

316. *See e.g.*, Draft of the Central America–United States Free Trade Agreement art. 10.4, § 2 n.1, Jan. 28, 2004, *available at* http://www.sice.oas.org/TPD/USA_CAFTA/Jan28draft/chap10_e.pdf (stating that the parties agree that the MFN clause they include in their treaty "does not encompass international dispute resolution mechanisms such as those contained in Section C of this Chapter, and therefore could not reasonably lead to a conclusion similar to that of the Maffezini case").

317. Salini Costruttori S.p.A. v. Hashemite Kingdom of Jordan, 44 I.L.M. 573, 592 (2005).

318. Plama Consortium Ltd. v. Bulgaria, 20 ICSID (W. Bank) Rev-FILJ 262, 330-33 (2005).

319. *Id.*

320. *See* Old Model BIT, *supra* note 59, art. 3; New Model BIT, *supra* note 76, art. 3.

not been adopted yet. The United Kingdom, for example, chose to include a reference to dispute settlement provisions in the MFN provision with its draft model.[321]

4. Exceptions and Limitations to the Standards

The New Model tries to limit the impact of the MFN and national treatment principles in a way that the treaty "shall not preclude a differential in the laws or regulations of a Contracting Party or in the exercising of the powers conferred by those laws and regulations, regarding rights or privileges granted to its own investors, or to investments or returns of investments of its own investors."[322] This reflects the ongoing efforts to balance between international commitments and national protectionism to ensure sustainable development.

This reservation, however, does not apply to some basic rights granted to foreign investors in the treaty.[323] Article 7 of the New Model lists several privileges that are excluded from the protection of the contingent standards since they are based on bilateral or multilateral commitments.[324] Rights or privileges granted to Israeli investors, which are allowed according to the New Model, remain open-textured and are subject to future arbitral interpretation and potential limitation. A similar arrangement exists in the NAFTA treaty, where Article 1108 excludes state procurement from the investments covered by these standards[325] and enables parties to schedule non-conforming measures.[326]

The above-discussed reservation conforms with existing Israeli laws that grant privileges to Israeli nationals. Israel officially discriminates between local factories or entrepreneurs and foreign corporations by giving local corporations special research and development ("R&D") grants. The Israeli government's policy of encouraging and supporting industrial

321. U.K. Model BIT, *supra* note 269, art. 3(3).

322. New Model BIT, *supra* note 76, art. 4.

323. *Id.* ("[N[either Contracting Party shall derogate from the provisions set forth in Articles 4 to 6 of this Agreement."). Articles 4 through 6 deal with compensation for losses, expropriation, and repatriation of investments and returns.

324. *Id.* at 7 (excluding benefits resulting from international tax agreements or domestic tax legislation, free trade agreements, international intellectual property agreements and Israeli BITs that were signed before July 1, 2003).

325. NAFTA, *supra* note 166, art. 1108(7).

326. *Id.* art. 1108(1)-(2).

R&D in Israel has been implemented by the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor[327] through the Encouragement of Industrial Research and Development Law 5744-1984.[328] One of its main programs, the R&D Fund, supports R&D projects of Israeli corporations by offering conditional grants ranging between 20 to 50 percent of the approved R&D proposal,[329] while the Israeli government shares in any commercial success.[330] These grants are not available to foreign investors who do not invest through an Israeli corporation.

With respect to government tenders, the Israeli government also grants certain benefits to local businesses that are not available to foreign bidders. The Mandatory Tenders Regulations prefer the use of Israeli products to imported products, provided that the price of the given Israeli product does not exceed that of the imported product by more than 15 percent.[331] The effect of this legislation is slightly reduced by the bilateral Government Procurement Agreement, which allows European Community companies to win local tenders without being obligated by the Mandatory Tenders Regulations.[332] Investment incentives and conditions are some of the main legislative instruments used to design investment allocation among multiple jurisdictions. The grants and preferences discussed above, which aim to develop know-how locally and promote national interests, have a significant impact on the way foreign investors perceive admission

327. State of Israel, Ministry of Industry, Trade & Labor, Office of the Chief Scientist, Support for Industrial R & D, *available at* http://www.moital.gov.il/NR/exeres/625D5C08-9096-4B88-BAEF-09E7CC0E19A9.htm (last visited on Nov. 10, 2009) (expressing the Chief Scientist's support of research and development programs, which operate on an annual budget of U.S. $300 million).

328. State of Israel Ministry of Industry, Trade, & Labor, The Encouragement of Industrial Research and Development Law, 5744-1984, http://www.moital.gov.il/NR/exeres/9F263279-B1F7-4E42-828A-4B84160F7684.HTM (lasted visited Jan. 28, 2010).

329. *Id.* § 28(a).

330. *Id.* § 21(a) (requiring the grantee to repay the grant by royalty payments in case of commercial success).

331. Mandatory Tenders Regulations (Preference for Israel Products and Mandatory Business Cooperation), 1995, Kovetz Ha-Takkanot 5755, 562, § 3(a) (Isr.); *see also id.* § 1 (defining "goods made in Israel" as "goods made in Israel or made in an area by a producer who is an Israel citizen, or a permanent resident of Israel, or a corporate entity registered in Israel, on condition that the price of their Israel content constitutes at least 35% of the proposed price").

332. Council Decision 97/474, art. 2, 1997 O.J. (L202) 72, 86 (EC).

of FDI in the Israeli market. That is, any preferences given to nationals limit de facto FDI inflows.

Another common exception in investment treaties allows host states to adopt measures necessary to protect security interests. Article 7, Section 1 of the New Israeli Model provides for a security exception and states: "Either Contracting Party may take measures strictly necessary for the maintenance or protection of its essential security interests. Such measures shall be taken and implemented in good faith, in a non-discriminatory fashion and so as to minimize the deviation from the provisions of this Agreement."[333]

This broadly drafted exception allows the Israeli government to avoid treaty commitments, such as MFN and national treatment standards, in order to maintain or protect "essential security interests" that are frequently hard to define. As can be found in other areas of Israeli law,[334] the legal principles of investment treaties can easily be limited by a continuous war or a terrorism consideration. It should be noted, however, that the language of Article 7, section 1, represents a compromise, because several Israeli government entities had expressed their concerns during the review of the Old Model about the potential risks of a very broad security exception.[335]

The provision, as a result, includes necessity, proportionality, and non-discrimination requirements in order for the exception to operate. These constraints are, in fact, being used frequently in judicial review of constitutional rights in Israel.[336] Interestingly enough, although Israel's security interests are more significant and imminent than those of many other states, several other leading models of investment treaties, such as the U.S. 2004 Model

333. New Model BIT, *supra* note 76, art. 7.

334. Eyal Benvenisti, *The Implications of Considerations of Security and Foreign-Relations on the Applications of Treaties in Israeli Law*, 21 MISHPATIM 221 (1992).

335. *See* Interview with Zvia Gross, former Gen. Counsel, Ministry of Defense, in D.C., U.S. (Mar. 24, 2007) (while the Ministry of Defense consistently acts to adjust financial regulation to security concerns, both the Ministry of Finance and Foreign Ministry promote constructive foreign relations and foreign direct investment).

336. *See generally* Yoav Dotan, *Judicial Rhetoric, Government Lawyers, and Human Rights: The Case of the Israeli High Court of Justice During the Intifada*, 33 LAW & SOC'Y REV. 319, 346-47 (1999) (examining the case of judicial review of minority rights by the Israeli High Court of Justice during periods of emergency or confrontation).

BIT, contain much more lax limitations on the use of the "security interests" exception.[337]

D. Expropriation

A key principle of the BIT is that a host state can expropriate a foreign investment only according to customary international law. This important BIT obligation is subject to extensive litigation in investment arbitration cases. Article 5, Section 1, of the New Model mirrors the customary international law standard,[338] according to which expropriation, nationalization, or any other "measures having effect equivalent to nationalization or expropriation" have to be (1) for public purpose related to the internal needs of the country; (2) on a non-discriminatory basis; and (3) against prompt, adequate and effective compensation.[339] The U.S. 2004 Model BIT adds another important layer, requiring expropriation to be in accordance with due process of law and a minimum standard of treatment as specified in the treaty.[340] The Israeli model, which formally lacks this requirement, provides that "investors affected shall have a right, under the law of the Contracting Party making the expropriation, to prompt review, by a judicial or other independent authority of that Contracting Party, of the legality of the expropriation and of the valuation of their investment."[341] A comparison between the Israeli and U.S. models, however, shows that a judicial review fulfills the due process requirement, and meeting the minimum standard of treatment should be part of that review process according to customary international law.

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337. *See, e.g.*, U.S. 2004 Model BIT, *supra* note 27, at 19 (referring only to the "necessity" element in its essential security exception).

338. The New Model did not significantly change the language of the "expropriation" provision of the Old Model. The only change is the deletion of a reference to compensation in "freely convertible currency."

339. New Model BIT, supra note 76, art. 6. The phrase "prompt, adequate, and effective compensation," known as the Hull Formula in public international law, was used by United States Secretary of State Cordell Hull in 1938 in his notes to the Mexican Government claiming compensation for expropriated agrarian lands owned by U.S. nationals in Mexico. The Hull Formula as a customary international law standard for compensation has been subject to an extensive debate. *See generally* ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 397-403 (2002) (reviewing the history of the Hull formula).

340. U.S. 2004 Model BIT, *supra* note 27, at 8.

341. New Model BIT, *supra* note 76, art. 5.

Israeli investment treaties do not make a distinction between direct and indirect expropriation and prefer to use the general term "measures having effect equivalent to nationalization or expropriation."[342] Nationalization or expropriation can impact the substance or value of the property or void the investor's control of it. The distinction between direct and indirect expropriation has significant implications in investment arbitration cases. Historically, early arbitration cases dealt with direct expropriation, where host states had deprived foreign investors of the legal rights of ownership to their property.[343] The parties in these cases usually agreed that a direct taking had occurred, but the tribunals faced questions regarding what rights to property were capable of being the object of a compensable taking, and what the proper standard of compensation was for the deprived investment.[344]

Modern cases, on the other hand, focus on indirect expropriations in the regulatory context and offer a thorough discussion on whether the economic impact of a regulatory action on the investment is considered "taking" and whether this taking is a violation of the expropriation standard in applicable bilateral or multilateral treaties or customary international law.[345] Among these actions include a municipal authority's permit requirement,[346] termination of a tax rebate regime,[347] and a new regulation prohibiting the export of hazardous materials to a neighboring country.[348]

The Israeli model lacks explanatory notes and does not provide any content or guidelines to the term "expropriation" in

342. *Id.* at 5.

343. Jan Paulsson & Zachary Douglas, *Indirect Expropriation in Investment Treaty Arbitrations, in* ARBITRATING FOREIGN INVESTMENT DISPUTES: PROCEDURAL AND SUBSTANTIVE LEGAL ASPECTS 145, 151 (Norbert Horn & Stefan Kröll eds., 2004). An example of a rare direct expropriation case in recent years is the *Middle East Cement Shipping & Handling* case, where the Ministry of Construction in Egypt issued a decree that effectively revoked the rights under a license for importation and storage of bulk cement at a Suez port. Middle East Cement Shipping & Handling Co. v. Egypt, 7 ICSID (W. Bank) 173, 189 (2005)

344. Paulsson & Douglas, *supra* note 343, at 151.

345. *Id.* at 151-157.

346. Metalclad Corp. v. Mexico, 5 ICSID (W. Bank) 209 (2002).

347. Feldman v. Mexico, 7 ICSID (W. Bank) 318 (2005).

348. S.D. Myers Inc. v. Canada, (NAFTA/UNCITRAL Arb. Trib. 2000) (Partial Award) *available at* http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/myersvcanadapartialaward_final_13-11-00.pdf.

the treaty.[349] It therefore leaves it to investment arbitrators to analyze each investment according to the "expropriation" jurisprudence in international investment arbitration. This jurisprudence is complex and inconsistent, and could potentially create a situation of conflicting decisions among investment arbitral tribunals, especially in the indirect expropriation context.[350] Several other models offer more concrete guidelines that can be used when interpreting an Israeli investment treaty, since many provisions in investment treaties are gradually meeting the legal requirements for being part of customary international law.[351]

The U.S. 2004 Model BIT, for instance, includes explanatory notes that differentiate between direct and indirect expropriation, although both are covered as long as they interfere with a tangible or intangible property right or interest in an investment.[352] According to these notes, direct expropriation is made through a formal transfer of title or outright seizure, while indirect expropriation is an action or a series of actions with an equivalent effect but without a formal transfer of title or outright seizure.[353]

An indirect expropriation, per these guidelines, will be examined on a case-by-case basis. Some of the factors that should be taken into account are: (i) the economic impact of a government action (not on a standalone basis); (ii) the extent to which a government action interferes with distinct, reasonable investment-backed expectations; and (iii) the character of the government action.[354] This formula provides a broad range of relevant factors and avoids a previously proposed and highly criticized general "test" for indirect expropriation, which tries to

349. *See* New Model BIT, *supra* note 76.

350. *See* ROBERT MELTZ, CONGRESSIONAL RESEARCH SERVICE, FOREIGN INVESTOR PROTECTION UNDER NAFTA CHAPTER 11, at 13-14 (2003).

351. *See generally* Andreas F. Lowenfeld, *Investment Agreements and International Law*, 42 COLUM. J. TRANSNAT'L L. 123 (2003) (arguing that the mass of almost identical bilateral investment treaties constitutes international legislation). This author supports Lowenfeld's view on this issue. Efraim Chalamish, *The Future of Bilateral Investment Treaties: A De Facto Multilateral Agreement?*, 34 BROOK. J. INT'L L. 303, 314-345 (2009).

352. U.S. 2004 Model BIT, *supra* note 27, at 38.

353. *Id.*

354. *Id.*

take into account multiple decisions of international tribunals and is impractical in a particular set of circumstances.[355]

A careful review of recent arbitration cases strongly emphasizes investors' frustration when their legitimate expectations, based on a reasonable reliance upon representations and undertakings by the host state, are not met.[356] The element of economic impact by the host state on the investment cannot be a conclusive factor in an indirect expropriation decision, but will support a decision regarding a regulatory taking. Such a decision is rendered prior to considering unlawful expropriation.[357] Alternatively, expropriation may be established in extreme circumstances where the entire investment value has been destroyed, even if the regulatory action is in the public's interest. This is done so that individuals need not carry the burden for the community.[358]

It remains to be seen whether future Israeli treaties will specify an expropriation formula and, if so, what additional factors tailored to the Israeli context will be integrated into such a formula. The lack of existing investment arbitration cases involving Israel-related treaties makes it difficult to have a clear answer. The jurisprudence in Israeli Law for compensation of regulatory takings, however, may be indicative of a trend in Israeli policy decisions. Although Israel's compensation law is heavily based on statutory law that has not changed much over the years, it has evolved through a series of Israeli Supreme Court decisions with an increasingly property-rights-friendly perspective, gaining the status of quasi-constitutional law.[359] Israeli policy makers may therefore desire that the judiciary, including international

355. *See generally* Paulsson & Douglas, *supra* note 343, at 145-58 (criticizing the general test approach).

356. *See e.g.* Pope & Talbot Inc. v. Canada, 7 ICSID (W. Bank) 43, 123-25 (finding no indirect expropriation where the Canadian government reduced the investor's allocation of a fee free quota for the export of softwood lumber to the United States since the elements of reliance and governmental undertaking were missing).

357. On the ambiguity between a taking and an unlawful expropriation and its consequences, *see* Paulsson & Douglas, *supra* note 343, at 148-50.

358. *Id.* at 158.

359. *See generally* Rachelle Alterman, *When the Right to Compensation for "Regulatory Takings" Goes to the Extreme: The Case of Israel*, 6 WASH. U. GLOBAL STUD. L. REV. 121 (2007) (discussing the development and expansion of regulatory takings and compensation law in Israel).

tribunals, extensively develop compensation rights for regulatory takings.

E. Compensation

As discussed earlier,[360] the notion that deprived investors should be compensated by host states for the loss of their investments has become an integral part of customary international law. This also explains the extensive discussion in academia and international arbitration concerning what should be considered a compensable expropriation. The Hull formula, which is the leading formula for compensation in international investment law in the developed world, calls for "adequate, effective and prompt" compensation.[361] The former concept of compensation, utilized by the developing world in the post-decolonization era in the 1960s and 1970s, offered an "appropriate compensation, in accordance with the rules in force in the state taking such measures in the exercise of its sovereignty and in accordance with international law."[362] This was influenced by the principle of permanent sovereignty of states over their natural resources and did not offer investors full compensation.[363]

While the standard of "adequate, effective, and prompt" compensation became an international consensus, arbitral tribunals differ on how to implement this standard in concrete cases, and more specifically, how to asses a reasonable rate of return and legitimate expectations of the investor. This is one of the most common yet complicated issues in investor-state

360. *See supra* Part VI.D.

361. LOWENFELD, *supra* note 351, at 399.

362. Permanent Sovereignty Over Natural Resources, G.A. Res. 1803 (XVII), at 15, U.N. Doc. A/5217 (Sept. 14, 1962); *accord* Charter of Economic Rights and Duties of States, G.A. Res. 3281 (XXIX), at 50, 52, U.N. Doc. A/RES/29/3281 (Dec. 12, 1974); Declaration on the Establishment of a New International Economic Order, G.A. Res. 3201 (S-VI), at 3, U.N. Doc. A/RES/3201(S-VI) (May 1, 1974); Programme of Action on the Establishment of a New International Economic Order, G.A. Res. 3203 (S-VI), at 5, U.N. Doc. A/RES/3203 (S-VI) (May 1, 1974); Development and International Economic Co-operation, G.A. Res. 3362 (S-VII), U.N. GAOR, 7th Spec. Sess., Supp. No. 1, U.N. Doc. A/10301 (Sept. 16, 1975).

363. Norbert Horn, *Arbitration and the Protection of Foreign Investment: Concepts and Means*, *in* ARBITRATING FOREIGN INVESTMENT DISPUTES: PROCEDURAL AND SUBSTANTIVE LEGAL ASPECTS 3, 8-9 (Norbert Horn & Stefan Kröll eds., 2004).

arbitration.[364] The market-based nature of the Israeli economy will make it easier for tribunals to evaluate the "fair market value" of an investment in Israel under consideration.[365]

In addition to the obligation to expropriate only under the conditions of the treaty, Israeli treaties also include a non-discrimination obligation and a mandatory compensation for requisitioning or destruction of property obligation, in case of losses resulting from war, armed conflict, or civil disorder.[366] Section 2 of Article 4 in the New Israeli Model supplements these obligations and specifically covers "requisitioning of property" by the host state's forces or authorities, or "destruction of property" by host states' forces or authorities, "which was not caused in combat action or was not required by the necessity of the situation," and accords investors "restitution or adequate compensation."[367] Israel is clearly vulnerable to internal and external conflicts, and the proposed language ensures equal and compensatory treatment to foreign investors in a wide range of scenarios.[368] It is interesting to note that the old generation Israeli treaties included in their "compensation for losses" provisions a reference to the payment requirement of a convertible currency,[369] but deleted it in the New Model as a result of the annulment of the currency control mechanism in the Israeli economy.[370] Other countries, such as the United States, prefer to include similar non-discrimination and compensation provisions as part of their BIT's

364. *See, e.g.* CME Czech Republic B.V. (The Netherlands) v. The Czech Republic, Final Award, 160 (UNCITRAL Arbitration Proceedings, Mar. 14, 2003), *available at* http://ita.law.uvic.ca/documents/CME-2003-Final_001.pdf. (Ian Brownlie, one of the three arbitrators, gave a separate dissenting opinion reducing the amount of compensation due to the claimant's dominant position in the Czech TV market). For a related discussion, *see* Horn, *supra* note 363, at 4-6.

365. Other economies, such as the Chinese, have not yet developed a full market value mechanism. This creates difficulties in calculating the amount of compensation on the basis of market value. *Tearing Down the Great Wall*, *supra* note 246, at 109.

366. New Model BIT, *supra* note 76, art. 4.

367. *Id.* Note that the difference between "adequate compensation" for requisitioning or destruction of property, and the more complete standard of compensation for losses resulting from expropriation of "prompt, adequate and effective," did not get much attention during the review process of the new model.

368. Nevertheless, it is important to note that the vast majority of investment arbitration cases deal with direct and indirect expropriation, rather than with losses resulting from military or civil conflicts.

369. Old Model BIT, *supra* note 59 ("Resulting payments shall be freely transferable in a freely convertible currency without delay").

370. *See* New Model BIT, *supra* note 76, art. 4.

"minimum standard of treatment" provision,[371] but Israeli treaties do not adopt such inclusive approach to the minimum standard.

To guarantee the investor full compensation, the New Israeli Model adopts the language of many other investment treaties and requires that the amount of compensation against unlawful expropriation ignores any reduction in an investment's value due to public knowledge of the expropriation, and that it carries interest at the applicable rate until the date of payment. The compensation should also be without delay, effectively realized, and freely transferable.[372] Although the New Model, like other investment treaties, states that the "compensation shall amount to the market value of the investment expropriated,"[373] the text does not provide any reference to an investment that is not made in "freely usable currency," as defined by the IMF in accordance with the Articles of the Agreement of the International Monetary Fund.[374] This lacuna, which makes it harder to evaluate an investment in the least developing economies, should be fixed by providing a currency exchange mechanism to evaluate such an investment.[375]

Finally, the Israeli investment treaty model includes an exception to the expropriation provision, by which any authorization of intellectual property rights pursuant to the 1994 Trade Related Aspects of Intellectual Property Rights agreement ("TRIPS") will not be considered expropriation for the purposes of the treaty.[376] This reservation follows Article 6, Section 5, of the U.S. 2004 Model BIT, according to which the expropriation provisions do not apply to authorization of intellectual property

371. U.S. 2004 Model BIT, *supra* note 27, at 8. Since the "minimum standard of treatment" provision in the U.S. 2004 Model BIT reflects the customary international law standard according to Annex A of the U.S. 2004 Model BIT, which consequently refers to all customary international law principles that protect economic rights and interests of aliens, it naturally includes the non-discrimination principle in treating losses of war or civil disturbance.

372. New Model BIT, *supra* note 76, art. 4.

373. *Id.*

374. *Id.* at 4 ("The term 'freely usable currency' shall mean a currency that the International Monetary Fund determines, from time to time, as a freely usable currency in accordance with the Articles of the Agreement of the International Monetary Fund and Amendments thereto").

375. For an example of such a mechanism, see The U.S. 2004 Model BIT, *supra* note 27, at 8-10. This model also includes payments made pursuant to expropriation and compensation obligations in the list of permitted transfers.

376. New Model BIT, *supra* note 76, art. 5.

rights in accordance with the TRIPS Agreement.[377] This recent addition to Israeli investment treaties reflects the new trend of adjusting existing Israeli treaties to international commitments, such as the TRIPS Agreement and other WTO Agreements, to avoid referring to local laws, which prioritize the multiple legal regimes that may apply to the foreign investment under consideration. Other than this unique exception, Israeli treaties follow recent global trends as discussed above and are gradually extending the safety net of providing full compensation to its foreign investors.

F. Repatriation of Investments and Returns

The ability of foreign investors to transfer their investments and returns is a crucial factor in their investment decision. In spite of the fact that foreign direct investment is defined as a long-term asset,[378] investors need to be assured that they will be able to transfer and use or reinvest their returns, while maximizing their investments through new investment allocations.

The Israeli economy formerly employed a currency control regime, which included certain limitations on transfer of investment and returns, to control the local currency and avoid high inflation.[379] During the 1990s the Israeli government managed to stop hyperinflation and reduced its intervention in many aspects of the Israeli economy in favor of a market economy, and, as a result, abolished the currency control regime.[380] The harsh consequences and lasting memory of that regime has, to this day, impacted the architecture of economic agreements and negotiations of investment treaties with Israel.

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377. U.S. 2004 Model BIT, *supra* note 27, at 9.

378. Investment treaties and investment arbitral tribunals are using a broad definition of 'investment' to include all kinds of investment. However, international investment law jurisprudence differentiates between long-term and portfolio investment and is reluctant to protect holders of portfolio investments due to their limited expectations and limited contribution to the host economy.

379. For example, as part of the limitations on shekel (the Israeli currency) foreign currency transactions by Israeli nationals, Israeli citizens were not permitted to transfer foreign currency between foreign currency accounts without first converting the sum into shekels.

380. The last phase of this elimination process was on Jan. 1, 1998, when the Israeli government allowed Israeli citizens to exchange shekels to foreign currency without limitation and to deposit money into foreign currency accounts in local banks in Israel.

In its investment treaties, Israel guarantees its foreign investors the rights of unrestricted transfer of their investments and returns.[381] Such transfers are promised "without delay in the freely usable currency in which the capital was originally invested or in any other freely usable currency agreed by the investor and the Host."[382] The model does, however, allow a contracting party to adopt restrictive measures to deal with "serious balance of payments difficulties" or "serious difficulties for the operation of the exchange of rate policy or monetary policy."[383] These restrictive measures must: (a) meet the conditions of the GATT framework and of Articles VIII and XIV of the Statutes of the International Monetary Fund; (b) not go beyond the necessary to remedy the situation; (c) not last for a period exceeding six months; and (d) be equitable, non-discriminatory, and in good faith.[384]

A comparative analysis of permitted restrictive measures in investment treaties leads to the conclusion that the Israeli model imposes strong restrictions on transfer control regulations and limits their circumstances, scope, and time, while other models allow such restrictions in the context of several local regulatory fields that require them. The far-reaching right of transfer of investment funds and returns and the limited exceptions should, therefore, be explained in the context of the continuous expansion of the free and competitive foreign exchange market in Israel. Moreover, foreign investors will be able to apply the MFN clause in order to benefit from the broader capital transfer provisions provided by recent Israeli treaties in comparison to old generation treaties under the foreign exchange control regime.

G. Dispute Settlement Mechanism

Many modern investment treaties include a separate section that provides a dispute settlement mechanism between the foreign investor and the host state in addition to the state-state dispute settlement mechanism. This important innovation of international investment law enforces the obligations of the contracting parties and grants a binding legal procedure without a direct privity

381. New Model BIT, *supra* note 76, art. 6.
382. *Id.*
383. *Id.*
384. *Id.*

between the investor and the host state.[385] This section will now discuss key provisions of the investor-state arbitration mechanism in the Israeli context.

While many developing countries rejected the concept of binding investor-state dispute settlement mechanisms in the 1980s and even in the 1990s, Israel has integrated this concept into its investment treaties since the inception of the BITs program in the early 1980s. By the time Israel negotiated and signed its first BIT with a developing country, Zaire, in 1985, Israel had already signed the ICSID Convention.[386] This was a significant step towards a legal integration into the global economy.

Article 8 of the New Israeli Model provides for several dispute resolution alternatives if negotiations between the parties are not fruitful within six months.[387] The investment treaty serves as an unconditional consent of the host country to the submission of a dispute to international arbitration, while the foreign investors provide their consent by initiation of the arbitration procedure.[388] This consent is necessary to apply the Additional Facility Rules of ICSID when applicable, and to enforce the arbitration award.[389]

An investor under the New Model can choose from the following options: (a) a local court of host country; (b) conciliation; (c) an ICSID arbitration, provided that both contracting parties are parties to the ICSID Convention; (d) arbitration under the Additional Facility Rules of ICSID in case only one of the parties is a party to the ICSID Convention; or, (e) an ad hoc arbitration under the Arbitration Rules of UNCITRAL.[390]

The New Model chose not to refer to the International Chamber of Commerce ("ICC") or the Arbitration Institute of the Stockholm Chamber of Commerce, with which the Israeli legal

385. For a description of the development of this binding legal mechanism in international investment law, see Jeswald W. Salacuse, *Is There a Better Way? Alternative Methods of Treaty-Based Investor-State Dispute Resolution*, 31 FORDHAM INTL L.J. 138, 140-53.

386. Israel signed the Convention on June 16, 1980, and it entered into force on July 22, 1983. ICSID, List Of Contracting States And Other Signatories Of The Convention, http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ContractingStates&ReqFrom=Main (as of Jan. 7, 2010).

387. New Model BIT, *supra* note 76, art. 8.

388. *See* Am. Mfg. & Trading Inc. v. Zaire, 5 ICSID (W. Bank) 11, 25-26 (1997).

389. *See* New Model BIT, *supra* note 76, art. 8.

390. *Id.* at 7-8.

system is not familiar.[391] The New Model, however, extended the list of options available to foreign investors, which previously included only a court of competent jurisdiction, ICSID arbitration, or an arbitrator or international ad hoc arbitral tribunal.[392] Practically, the majority of investment arbitration cases are initiated in ICSID.

The Israeli New Model, unlike many other bilateral and multilateral models,[393] does not describe the investor-state mechanism of dispute settlement in detail and only provides the investor with the possible alternatives. Nevertheless, some of these provisions have attracted special attention in arbitration jurisprudence and have an impact on the scope of investor protection in Israeli investment treaties. This section will discuss some of these key provisions.

First, the New and Old Israeli models both include a cooling period of six months, within which investment claims cannot be brought during settlement negotiations.[394] Different models suggest different cooling periods in order to explore diplomatic options in good faith, and six months is within the range of existing practice.[395] Nevertheless, most arbitral tribunals found that the cooling period is procedural and not jurisdictional, and thus investors cannot be denied jurisdiction if they did not provide the required notification of a dispute prior to commencing arbitration and did not observe the cooling period.[396] It should be mentioned, though, that some other cases, such as *Enron Corp. v. Argentina*,

391. These institutions are perceived by the Israeli legal system as expensive European institutions that do not offer the adequate efficiency expected from alternative dispute resolution forums.

392. Old Model BIT, *supra* note 59, art. 8, § 2. The new additions, conciliation, and ICSID Additional Facility arbitration reflect developments in international arbitration practice in recent decades. The New Model also limits the ad hoc arbitration to UNCITRAL arbitration due to its popularity and harmonizing effect on international arbitration.

393. *See, e.g.* U.S. 2004 Model BIT, *supra* note 27 (adopting many new provisions that increase the effectiveness, efficiency, transparency, and equality of the dispute settlement mechanism in the treaty).

394. New Model BIT, *supra* note 76, art. 8; Old Model BIT, *supra* note 59, art. 8(2).

395. While the U.K. model provides for 3 months cooling period, both the German and the U.S. models provide for 6 months cooling period.

396. *See e.g.*, Bayindir Insaat Turizm Ticaret Ve Sanayi AS v. Pakistan, ICSID (W. Bank) Case No. ARB/03/29, Decision on Jurisdiction, ¶ 102 (Nov. 14, 2005).

have disagreed and concluded that this obligation is jurisdictional.[397]

Under the New and Old Israeli models, assuming the cooling off period has expired, the investor can submit an investment claim using one of the above-mentioned options. While many arbitral tribunals have previously questioned the nature of the consent to the procedure provided by the investor and host state,[398] the *American Manufacturing & Trading Co. v. Zaire* tribunal clarified that the state gives its consent in the treaty and the investor gives his or her consent in the request for arbitration.[399] Thus, there is no need to have both consents in the same document in order to express the "meeting of the minds" for the arbitration process.

In addition to satisfying the jurisdictional requirement of consent in writing in Article 25 of the ICSID Convention,[400] this mutual consent also satisfies the agreement in writing requirement of Article II of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention").[401] Indeed, the lack of privity between the parties has triggered extensive literature referring to the investment arbitration process as an enforced procedure of private players against states in international law.[402]

The Israeli New Model specifically addresses the consent requirement and refers to Chapter 2 of the ICSID Convention and Article II of the New York Convention. Similar to the U.S. 2004 Model BIT,[403] Article 8 of the Israeli New Model provides that a

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397. Enron Corp. v. Argentina, 11 ICSID (W. Bank) 268, 272 (2007). Although the tribunal found that the cooling period requirement is jurisdictional, it also concluded that an original notification would satisfy this requirement with respect to any future expansion of the claim.

398. *See, e.g.*, Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt, 3 ICSID (W. Bank) 45, 145-49 (1988).

399. Am. Mfg. & Trading Inc. v. Zaire, 5 ICSID (W. Bank) 11, 25-26 (1997).

400. *ICSID Convention, Regulations and Rules*, *supra* note 196, at 18.

401. Convention on the Recognition and Enforcement of Foreign Arbitral Awards art. II(1), June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38. Although Article II(2) defines agreement in writing as an arbitral clause in a contract or arbitration agreement, arbitral tribunals have found that the embedded consent in the investment treaty satisfies the agreement in writing requirement and is allowed to enforce non-ICSID awards under the New York Convention. *See also Occidental Exploration and Prod.*, 2 Lloyd's Rep. at 2444.

402. *See generally* Jan Paulsson, *Arbitration Without Privity*, 10 ICSID REV. FOREIGN INV. L. J. 232 (1995) (discussing how the BIT created an extension of arbitral jurisdiction to private complainants who do not have privity to the treaty).

403. U.S. 2004 Model BIT, *supra* note 27, at 25.

state's consent in an investment treaty and an investor's consent in an investment claim satisfy the requirements of Article 25 of the ICSID Convention and Article II of the New York Convention.[404] Although, as discussed above, this assumption is not questionable anymore in investment arbitration jurisprudence, such clarification prevents any potential ambiguity in future arbitration cases based on Israeli investment treaties.

One of the most challenging topics arising out of dispute resolution provisions is parallel proceedings. The term refers to a situation where the application of multiple investment treaties and recourse to national courts encourage investors to use various forums simultaneously with respect to the same subject matter.[405] Therefore, investment models have tried to limit an investor's claim to a single forum in several different ways.[406]

One approach is to force an investor to elect a forum when initiating the first proceeding. Investment treaties that follow this approach usually include a "fork in the road" provision, which prevents an investor from applying to international arbitration if she already brought a claim in a domestic court. Treaty claims, which are based on investors' protection standards, and contract claims, which are based on rights and obligations of respective parties in investment agreements, will be considered as different legal sources for this purpose. According to investment arbitration jurisprudence and scholarship, this election will apply only when the cause of action in the different proceedings is identical.[407] In most cases, however, investors turn to arbitral tribunals for treaty claims, such as violation of the fair and equitable standard, while at the same time use local courts for breach of investment contract claims, including domestic administrative remedies. Thus, the use and application of this method in investment jurisprudence is very limited.

Another approach is for the investor to waive all other claims by providing a waiver at the time of the initiation of the claim before an investment tribunal.[408] Both NAFTA and the U.S. 2004

404. New Model BIT, *supra* note 76, art. 8.

405. *See* MCLACHLAN, *supra* note 4, at 80.

406. For more on the forum shopping dilemma in international investment arbitration, see Parallel State and Arbitral Procedures in International Arbitration, Dossier III from the ICC Institute of World Business Law, ICC Publication No. 692, 2005 Edition.

407. *See* MCLACHLAN, *supra* note 4, at 95-96, 99-100, 104.

408. *Id.* at 96.

Model BIT follow this approach.[409] Article 26(2) of the U.S. Model requires the claimant to waive "any right to initiate or continue before any administrative tribunal or court under the law of either Party, or other dispute settlement procedures, any proceeding with respect to any measure alleged to constitute a breach referred to in Article 24."[410] The waiver does not apply to interim injunctive relief or other non-monetary damages in local courts.[411]

NAFTA tribunals, interpreting similar text, gave a very broad interpretation to this language to cover all possible legal procedures and avoid multiple recoveries of damages.[412] Additionally, both NAFTA and the U.S. 2004 Model BIT require a similar waiver from an investor on behalf of the organization that is owned or controlled by the investor either directly or indirectly[413] to avoid double recovery through one of the enterprises owned or controlled by the claimant. This method will encourage investors to exhaust local remedies first, and if not satisfied, apply to arbitral tribunals that will be able to review both the breach of treaty claims and the initial judicial treatment as part of the fair and equitable standard.[414]

The Israeli New Model, which does not follow either of the methods discussed above, provides that an investor can bring a claim to an international tribunal as long as a national court has not yet delivered a judgment on the "subject matter" of the dispute.[415] This hybrid approach encourages forum shopping before any judgment is given, and does not address the consequences of multiple judgments given by both local courts and arbitral tribunals. The open-textured reference to "subject matter" is also not detailed enough to provide the scope of the claims and proceedings covered by the provision.

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409. NAFTA, *supra* note 166, art. 1121; U.S. 2004 Model BIT, *supra* note 27, at 26.

410. U.S. 2004 Model BIT, *supra* note 27, at 26.

411. NAFTA, *supra* note 166, art. 1121; U.S. 2004 Model BIT, *supra* note 27, at 26.

412. *See, e.g.*, Waste Management Inc. v. United Mexican States, 5 ICSID (W. Bank) 443 (2000). In this case, the NAFTA tribunal extended the application of waiver to proceedings that are based on the municipal law of Mexico. The tribunal concluded that the waiver applies to any claims, whatever their legal basis, that were derived from or concerned the same measures adopted by the host state, which were to be the subject of the investment arbitration claim. *Id.* at 444.

413. NAFTA, *supra* note 166, art. 1121(1); U.S. 2004 Model BIT, *supra* note 27, at 26.

414. MCLACHLAN, *supra* note 4, at 107.

415. New Model BIT, *supra* note 76, art. 8.

To summarize, the extensive BIT network provides foreign investors with a variety of fora for their investment claims, including different arbitration regimes in addition to the choice between a national court and arbitration. Consequently, multinational corporations can structure their organizations and transactions to benefit from this BIT network. Establishing a subsidiary in a third country with which an investor's home state has a BIT is a popular structure. Many of Israeli BITs have been signed for a period of ten years and future review of these BITs may lead to revisions of relevant provisions based on recent experience with multinationals' structures.[416]

Finally, several recent model BITs include additional dispute settlement provisions, which aim to address sustainable development needs and the unbalanced pro-host states atmosphere of investment treaties, as well as the effectiveness and transparency of the proceedings. For instance, the U.S. 2004 Model BIT and the IISD Model International Agreement on Investment for Sustainable Development mentioned above include the transparency of the documentation of the arbitral proceeding, the ability to submit *amicus curiae* by a person or an entity that is not a disputing party, the ability to refer to expert reports, the choice to consolidate two or more claims that have a question of law or fact in common and arise out of the same events, and possible appellate review.[417] These provisions did not find their way into the Israeli models, and any future review of existing Israeli investment treaties should take them into account as part of the global approach to investment arbitration. In fact, many of these provisions reflect arbitration jurisprudence, which Israeli investors are also subject to according to the developing international investment common law.

VII. CONCLUSION

The developing story of Israeli investment treaties combines two significant phenomena: a success story of integration into the global economy and an increased use of international investment

416. *See* Julian D.M. Lew, *ICSID Arbitration: Special Features and Recent Developments, in* ARBITRATING FOREIGN INVESTMENT DISPUTES: PROCEDURAL AND SUBSTANTIVE LEGAL ASPECTS 267, 281 (Norbert Horn & Stefan Kröll eds., 2004).

417. U.S. 2004 Model BIT, *supra* note 27, at 27, 29-32, 40; IISD MODEL AGREEMENT, *supra* note 8, at 31-34.

arbitration following the proliferation of investment regulation in international law. Bilateral investment agreements were introduced in Israel in the mid 1970s as part of the global post-colonialism new era, but became more popular since the early 1990s following the collapse of the Soviet Union, among other geopolitical changes. This created opportunities for Israeli investors in several developing countries. The simultaneous transition of the Israeli economy from import-capital to export-capital status encouraged the Israeli government to adopt a BIT program with developing countries in order to protect Israeli investors in unstable economies. Host states perceived this program as another tool to increase their foreign investments due to the positive signal of a more protected and investment-friendly economic environment.

The first Israeli investment treaties focused geographically on Eastern Europe, and their structure was influenced by European models of investment treaties, which had a limited role in investment liberalization. These treaties traditionally did not apply their investors' protection provisions to pre-establishment investments in order to promote market access. Global economic and political changes in the world economy have brought the Israeli government to sign and negotiate BITs with developing countries from various regions. Although some of these recent treaties were influenced by the language of the emerging North American BIT models, their structure nevertheless follows European treaties and lack important concepts which exist in the North American BIT models. Thus, for example, the new U.S. 2004 Model BIT, which has a significant impact on shaping modern investment treaties and investor-state arbitration, includes investment liberalization provisions, applies investors' protection standards to the pre-establishment phase, secures sustainable development of host states through human rights provisions, and introduces new concepts to dispute settlement mechanism, such as review and amicus brief procedures. Adoption of these important, potential, innovative elements should be considered as part of any future review process of the Israeli BITs.

My thorough review of the Israeli BIT program through interviews, policy documents, and textual analysis did not identify any coherent program by the Israeli government. BIT negotiations are frequently driven by *ad hoc* political or economic needs

without a careful review of the potential consequences of these agreements down the road.

An inter-governmental team had reviewed the Israeli Old Model BIT and introduced the New Model in 2004, which revised the text of the Old Model to respect international commitments, better protect security and other national interests, and implement the negotiation experience of the Israeli government. This team did not, however, provide any consistent program with respect to additional candidate states. Since literature shows mixed results regarding the impact of investment treaties on the volume of foreign investment, and since the treaty-making process involves significant resources and needs to create a national economic policy, this article calls for the centralization of the BIT making process in Israel. Among the factors to be considered by this centralized team will be strengthening trade blocs and growing investment partners, in addition to concluding investment treaties with developing countries to position Israel as a developed and capital-exporting economy.

International investment law experienced a plethora of bilateral investment treaties in recent years, and investor-state arbitration cases based on these treaties. The large number of investment arbitration decisions continues to shape modern investment law jurisprudence, which has an immense impact on the interpretation of investment treaties, including the ones to which Israel is a party. As discussed in other studies on this matter, the current practice of BIT making, the similarity of their content, and "common law" style legal analysis of investment tribunals contribute to the "multilateralism" element of investment treaties. Consequently, Israeli treaties will be subject to interpretation based on investment jurisprudence. In fact, this article identified several differences between various BIT models, which reflect various countries' response to precedents of previous arbitration decisions. The New Israeli Model and the treaties that were signed or ratified afterwards, as well as the old agreements that were signed based on the Old Model, do not reflect many of these decisions. Since the Israeli treaties are usually in force for ten years, many of them will be up for renewal in the upcoming years, which will be an opportunity for the parties to respond to recent investment jurisprudence. This suggested review process could be

accompanied by a reassessment of the New Model and the current BIT program in Israel.

The recent slowdown in BIT negotiation activity and the only few investment arbitration cases concerning Israeli treaties can be explained by the role BITs play in the Israeli business, legal, and governmental communities. As demonstrated by recent studies, Israeli executives in multinational corporations rarely know if there are BITs in force with the countries in which they operate, nor do they realize the importance of their investor-state arbitration mechanism. Unfortunately, the Israeli government does not play an active role in changing this reality. Moreover, international arbitration forums are perceived as expensive and inefficient, and thus Israeli and foreign investors prefer to apply to local courts. Finally, while accepting the fact that international investment tribunals would be the appropriate forum to protect investors' rights and enhance the welfare of host states, there is a constant fear on Israel's part of the harsh consequences of sovereignty's derogation. This comes as a result of the development of the Israeli legal system and the essence of traditional skepticism concerning international legislation and tribunals, along with the political push for state sovereignty.

The Israeli government is consistently trying to avoid the utilization of multinational bodies and the globalization of its political and commercial disputes. This reluctant approach is also supported by the New Israeli Model, which prefers judicial certainty upon a comprehensive analysis by arbitrators in future investor-state cases in various provisions of the model. Moving forward, an increased number of investment arbitration decisions may bring parties to Israeli treaties to use those provisions for investor protection. For instance, international transactions are already being structured to include corporate vehicles in the jurisdiction of the relevant treaties.

After years of growing privatization and liberalization of foreign investment, many countries had become aware of the negative consequences of the process, which has led to the nationalization of several key industries and the indirect expropriation of foreign investments in countries that were traditionally perceived as friendly to foreign investors. This deja-vu feeling of "protectionism" can bring BITs back to the center of investment law in Israel, along with the ongoing academic

discussion revolving around their economic effectiveness. Clearly, in times of economic uncertainty and the slowing of global markets, aggressive competition for foreign capital can bring these tools to the center of discussion.

Finally, Israel serves as an important case study for investment treaty practice as a country in transition from a developing to developed economy. Both the Israeli BIT program and the language of draft models reveal the way Israel chooses to balance its integration into the global economy with protecting its sovereignty. It remains to be seen whether and how the use of Israeli BITs by the private sector, as interpreted by investment tribunals, will influence this balance. Although BITs had a limited impact so far on other branches of the Israeli administration, its potential influence on foreign investment policy and full participation in the global economy, including its emerging legal institutions, is major.